The Alote Estate and Another

Vs

R. B. Seth Hiralal Kalyanmal and Others

Civil Appeal No. 1010 of 1966

(J. M. Shelat, K. S. Hegde, A. N. Grover JJ)

20.02.1970

JUDGMENT

GROVER, J. -

1. This is an appeal by special leave from a judgment of the Division Bench of the Madhya Pradesh High Court reversing the order of the Company Judge in an application made by respondent No. 1 for an inquiry into the allegation that the consideration for 18,000 shares of the Vikram Sugar Mills Ltd. (now under liquidation) valued at Rs. 18 lakhs was not fully paid up by the shareholders, namely, the present appellants.

2. The facts may be succinctly stated. Appellant No. 1, the Alote Estate, was a firm consisting of two partners at the material time. It came into existence in 1944 when Vikram Sugar Mills Ltd., hereinafter called the "company", was proposed to be floated. The two partners of the firm were His Highness Col. Sir. Vikramsingh Rao Pawar, Ruler of the State of Dewas (senior), and R. K. N. Gajapati Raju of Vaizagapatnam who died some time in 1946 with the result that the firm was dissolved. In 1947, the Ruler of Dewas (senior) was taken in adoption by Her Highness the Senior Dowager Maharanisaheba of Kolhapur. He assumed the name and title of His Highness Maj. Gen. Sir Shahaji Chhatrapati Maharaja of Kolhapur. After the constitution of the firm called the Alote Estate, the company was corporated in February, 1944. The firm held extensive agricultural land which was suitable for cultivation of sugarcane. It had transferred 6,000 acres of its holding to the company in lieu of 18,000 fully paid up shares of Rs. 100 each which were registered in the name of the firm.

3. Respondent No. 1 was originally a director of the company. He made a proposal for advancing debenture loan of Rs. 20 lakhs to the company which proposal was accepted by the board of directors as also at an extraordinary general meeting of the company on September 16, 1946. He was appointed managing agent of the company. On the same date at the meeting the shareholders of the company passed a resolution that out of 6,000 acres of land acquired by the company from the Alote Estate 2,000 acres selected by respondent No. 1 or his representative be returned and retransferred to the estate. In consideration of such transfer 9,000 shares were to be surrendered by the Estate. Effect was given to this resolution and in the list of shareholders the number of shares held by the firm was shown as 9,000 instead of 18,000 subject to confirmation by the court. A resolution was passed on October 27, 1947, for

reduction of the capital from 60 lakhs to Rs. 35 lakhs. The court was also moved for giving permission for reduction of the capital. On January 23, 1950, Prabhakar Parashuramji Pandit - a shareholder - filed before the High Court a petition under sections 166 and 162 of the Companies Act, 1913, for winding up the company. On April 2, 1951, two joint liquidators were appointed.

4. The liquidators took steps to settle the list of contributories and objections were raised by His Highness the Maharaja of Kolhapur as also by the firm against inclusion of their names in that list. While these proceedings were pending an application was filed by respondent No. 1 on October, 31, 1961, praying that an inquiry be made in respect of the price paid for 6,000 acres of land before the allotment of the shares and "to hold the Alote Estate and His Highness the Maharaja of Kolhapur liable as contributories to the extent of money's worth not found to have been fully paid in addition to and independently of the liability for Rs. 9 lakhs" which according to the joint liquidators was the amount of liability of the Maharaja as a contributory. It was alleged, inter alia, that on an average the price per acre paid for 6,000 acres of land before the allotment of the shares was approximately Rs. 30. On that basis the Maharaja and the Alote Estate were liable as contributories in the sum of Rs. 16 lakhs as the shares were not fully paid by value in kind. The Maharaja and the Alote Estate in reply took up the position that in the absence of rectification of register by appropriate action they were not liable to pay as contributories because they held shares which were fully paid up. As regards the company's resolution to give up 2,000 acres out of 6,000 acres and reduce the value of shares allotted to Rs. 9 lakhs it was maintained that the same was an independent transaction and its effect could be considered only in appropriate proceedings in accordance with law.

5. The learned Company Judge by his order dated July 31, 1962, held that in a proceeding for winding up and while settling the list of the contributories it was not open to go behind the transaction entered into at the time of the formation of the company and that the consideration which had been freely accepted by the company could not be challenged as being inadequate in the absence of any allegation of fraud. He was further of the view that the contention of respondent No. 1 that the valuation of the land was Rs. 30 and not Rs. 300 per acre could not be inquired into and it was not necessary to consider whether such inquiry was barred by limitation in view of section 235 of the Act. It was, however, observed that if the allegation of respondent No. 1 was that the Alote Estate as an officer of the company was guilty of misfeasance or breach of trust the application having been made more than three years from the date of first appointment of liquidators would be clearly barred. Reference was made to numerous English and Indian decisions for coming to the conclusion that a fully paid shareholder could not be called upon to contribute towards the assets of the company in respect of such shares held by him. Other points were left for decision after the petition for confirmation of the resolution of the company was disposed of.

6. Respondent No. 1 filed an appeal under the Letters Patent. The Division Bench hearing the appeal seems to have been influenced by the possibility that the land had been purchased by the Alote Estate at a small fraction of value for which it had been sold to the company largely owing to the Maharaja being all powerful in the conduct of its affairs. It was considered that an inquiry would be necessary when there was a

prima facie indication that the allottee of the shares had paid only a fraction of the nominal value.

7. Now section 156 of the Act deals with the liability as contributories Clause (iv) of sub-section (1) provides that in the case of a company limited by shares no contribution shall be required from any member exceeding the amount unpaid on the shares in respect of which he is liable as a present or past member. Section 158 defines the term "contributory". It means every person liable to contribute to the assets of the company in the event of its being wound up. Under section 184 the court shall settle the list of contributories with power to rectify the register of members in all cases where rectification is required in pursuance of the Act. Sections 185 and 186 confer power on the court to require delivery of property from a contributory and to order payment of debts determined by it.

8. The material question, therefore, was whether the appellants could be placed on the list of contributories. It could hardly be disputed that a shareholder of fully paid up shares will not be placed on the list of contributories and made to contribute towards the assets of the company unless the register is rectified and it is determined in appropriate proceedings that he is not a fully paid up shareholder.

9. In England the rule which has been accepted as settled is that although the court can inquire into an allegation that owning to fraud the contract relating to fully paid shares was vitiated, unless the contract is impeached, mere inadequacy of price is not sufficient of itself to invalidate the contract. In the words of Vaughan Williams L.J. in In re Innes and Co., Limited ((1903) 2 Ch Div 254, 262) :

"You must show that these shares not having been paid for at all, the contract for purchase was a colourable transaction, and that in truth and in fact, qua value, these shares were not part of the consideration ....."

As stated in Palmer's Company Law, 21st edition, pages 190-191, the consideration for the allotment of shares may be money or money's worth e.g., the transfer to the company of property. If a valid contract is made for the acceptance by the company of specified property in payment of shares the court will not whilst the contract stands inquire into the value of the consideration even at the instance of the liquidator. Where, however, the contract is fraudulent or shows on the face of it that the consideration given to the company is illusory or is clearly not equivalent to the nominal value of the shares the shares cannot, to this extent, be treated as fully paid and the shareholder may be held liable to pay for them in full. It is significant that no steps were taken by the liquidators to have the register rectified or the contract entered into by the company with the appellants avoided by means of appropriate proceedings. Even in the application filed by respondent No. 1 in October, 1961, there was no allegation of fraud. The fact stated related more to inadequacy of price or consideration and not to its being illusory or the like. In our judgment the learned single judge was right and the Division Bench was in error in directing an inquiry into the question whether the appellants had paid consideration which was inadequate.

10. The appeal is consequently allowed and the order of the Division Bench is set aside and that of the learned single judge restored with costs.

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