

# NAGPUR HIGH COURT

Balwant Transport Co. Ltd

Vs

Y.H. Deshpande

Misc. First Appeal No. 86 of 1950. decided on 23.11.1953

(Hidayatullah and R. Kaushalendra Rao, JJ.)

06.05.1950. 23.11.1953

## ORDER

### **R. Kaushalendra Rao, JJ.**

1. This case comes before us on a reference by Mudholkar, J. who found that the point involved in it was important and was not covered by authority. The appellant, Shri Balwant Transport Company, Ltd. (hereinafter called the Company) has come up in appeal against an order passed under section 34 of the Indian Companies Act, 1913, requiring the Company to enter upon the register of its shareholders the name of the respondent, Shri Y.H. Deshpande, Advocate of Amravati. The facts of the case are as follows.

2. One R.S. Sapate was a shareholder in the Company and owned 31 shares. He was indebted to some person who obtained a money decree against him. In execution of that money decree one share bearing No. 000582 was attached and sold by public auction. It was purchased by Shri Y.H. Deshpande, the respondent, for Rs. 175/-. Shri Deshpande thereupon informed the Managing Director of the Company on 16-9-1948 that he had purchased the above share and requested that his name be entered on the register of shareholders. Along with this application to the Managing Director, he attached a true copy of the Court's order. On 6-11-1948, the Company sent back the letter on the ground that it was not in the prescribed form and according to law.

3. On 25-11-1948, Shri Deshpande resubmitted the papers for getting his name registered and on 21-4-1949 made the application under Section 34 of the Indian Companies Act out of which the present appeal arises, alleging that he had learnt that the directors of the Company had passed a resolution, rejecting his application.

4. The application was made on the ground that the refusal of the directors to receive Shri Deshpande as a shareholder was lacking in good faith. The Company in its reply admitted some of the facts but denied any knowledge about the indebtedness of Sapate or the Civil Suit, against him. It admitted that a prohibitory order in respect of the shares was communicated to the Company. The Company stated that the Managing Director had informed Shri Deshpande on the first occasion that he had not sent a certified copy of the Court's order and that his application

was placed before the Board of Directors in their meeting held on 6-11-1948 but it could not be considered as it was incomplete because it was neither in proper form nor duly stamped nor accompanied by a certified copy of the Court's order evidencing Shri Deshpande's title to the share. The Company further denied that the rejection was not in good faith and stated that in view of Article 9 of the Articles of Association of the Company, the directors had an absolute and uncontrolled discretion to refuse registration of any transfer of a share,, and the directors were, therefore, within their rights in refusing to register the name of Shri Deshpande. It stated that merely because Shri Deshpande had purchased one share in a Court auction did not absolve him from complying with the requirements of the law and the Articles and from affixing proper stamps and using the necessary form.

5. In a later statement which the Company filed it was alleged that the application of Shri Deshpande made on 25-11-1948 was placed before the Board of Directors of the Company on 27-9-1949 and was rejected by a resolution. The copy of that resolution is not before the Court, but in that statement the gist of it is given as being that in the opinion, of the directors it was not in the interest of the Company to admit Shri Deshpande to the membership of the Company as a shareholder. This resolution of the Board of Directors, it was stated, was communicated to Shri Deshpande during the pendency of the case.

6. In meeting the contention of Shri Deshpande the Company alleged that the transfer from Sapate to Shri Deshpande was fraudulent and collusive. It stated that Sapate was not on good terms with the other members and directors of the Company and had been following a policy of obstruction prejudicial to the interests of the Company. The Company averred that in order to oppose more successfully the affairs of the Company, Sapate wanted to make his lawyer friend, the present respondent, a member of the Company. Sapate also wanted his brother-in-law Gudhe to become a member as well. The Company alleged that Sapate anticipated that a private transfer of shares to these two persons was not likely to be effective as the directors were likely to refuse to receive them as shareholders. To overcome the obstacle of Article 9 which gives discretionary powers to the directors, Sapate resorted to the expedient of having the shares sold in a Court auction to Shri Deshpande and his brother-in-law Gudhe. The Company alleged that by this means Sapate hoped that the Company would be required to enter the names of these persons on the register of shareholders without the directors being able to exercise their discretionary powers: under Article 9 of the Articles of Association of the Company.

7. In giving the particulars of fraud and collusion, the Company alleged that the decree passed against Sapate was only for Rs. 771/- out of which Sapate had already paid off Rs. 450/-, and the balance was well within his means to pay; that he allowed his shares to be sold for Rs. 175 and Rs. 200/- each to his lawyer and brother-in-law and the auction showed that there was hardly any outside competition; that there was no investment as such by Shri Deshpande, except to qualify himself to participate in the Company's affairs owning a single share in the private company; that Shri Deshpande was a friend of Sapate and had been his lawyer in most of his cases; that the purchase price was actually paid by Sapate himself and that the Company had no notice of the Court auction of the share in question. The Company therefore claimed that the transaction was vitiated by fraud and collusion.

8. The learned District Judge who tried this case framed a number of issues. He came to the conclusion that Shri Deshpande was entitled to have his name registered as a shareholder of the

Company and that the refusal to register his name was arbitrary. He accordingly passed an order requiring the Company to enter the name of Shri Deshpande as a shareholder on its registers and allowed the application with costs.

9. In this appeal the Company urges that it had an absolute discretion to exercise in the choice of persons whose transfers it should recognize, that its action was not open to scrutiny and that it was neither arbitrary nor mala fide. It also objects to the decision of the learned District Judge that in Court sale the Company has no option but to register the purchaser as a shareholder, any Clause in the Articles of Association giving them a discretion, notwithstanding. The learned counsel for the Company also drew our attention to the fact that the matter had not really been finally decided till after the application was made; but he did not urge the ground too strongly that the application was premature.

10. The law on the subject has been admirably summed up in Halsbury's Laws of England, Volume 5, p. 281 (Hailsham's Edn.). It is there stated :

"The power of refusing to register a transfer is usually conferred on the directors, and in such a case must be exercised by a resolution of the board of directors. It is a discretionary power and must be exercised reasonably and 'bona fide' and for the company's benefit and not arbitrarily, though in the absence of evidence to the contrary, the power will be presumed to have been properly exercised.

Where there are several grounds on which the power can be exercised, the directors are bound to state on which ground they act, unless excused from so doing by the articles although they need not in any case give the reasons which influenced them in exercising their discretion or that ground whether they do so under an absolute power or under a power to refuse in specified events. If the directors do give their reasons, the Court will examine them, but it will not overrule the decision of the directors because it disagrees with the conclusion they reached as to the advisability of refusing the transfer. It will, however, do so if the directors have acted on a wrong principle".

11. The learned Judge of the trial Court came to the conclusion that the exercise of discretion was arbitrary and, regard being had to what is stated above, we have to see whether the finding is proper or not. We cannot overlook the fact that under the proviso to Section 38 this appeal is to be treated as equivalent to one filed under section 100, C.P.C. A finding fairly reached on the evidence would, therefore, be binding. In the present case, the learned Judge of the trial Court did not consider the question of onus at all. He felt that it was for the Board of Directors to justify their order, rather than for the applicant before him to show that there was lack of 'bona fides'. But it is well settled that, the onus is on the shareholder to prove that the action of the directors was 'mala fide': - *In re, Gresham Life Assurance Society; Ex Parte Penney*<sup>1</sup>, *In re Coalport China Co*<sup>2</sup>. *In re, Hannan's King (Browning) Gold Mining Co., Ltd*<sup>3</sup>., *Sutherland (Duke) v. British Dominions. Land Settlement Corporation, Ltd*<sup>4</sup>. As in the present case the learned Judge, reached his decision after placing the onus, wrongly, the decision is open for further consideration even in an appeal under section 100, Civil Procedure Code - '*Peddi Reddi Jogi Reddi v. Chinnabbi Reddi*<sup>5</sup>, and *Jogeshchandra Roy v. Emdad Meah*<sup>6</sup>,

12. In the resolution which the Company passed and which is described at page 7 of the paper book, it merely stated that it was not in the interests of the Company to admit the applicant to the membership of the Company as a shareholder. Clause 9 of the Abides of Association says :

"Clauses 18 to 23 inclusive, of Table A, annexed to the Indian Companies Act, 1913, shall apply with the following modification :-

Clause 20 shall be modified so as to provide that the directors may in their absolute and uncontrolled discretion refuse to register any transfer of share; whether fully paid or not, where in the opinion of the directors it is not to the interest of the Company to admit the proposed transferee to membership or (if he is already a member) to allow him to increase his holding. Save this change the other provisions of clause 20 will remain, intact".

13. Under this Clause the directors enjoy very vast powers. Unless it can be shown that a power so vested in them was exercised 'mala fide' or for any collateral purpose, the Court cannot overrule the decision of the directors and substitute its own judgment about the desirability of bringing the name of a person as a shareholder in the register.

14. In *in re, Smith, and Fawcett, Ltd.* 1942 1 All England Reporter 542 (G) Court of Appeal laid down certain rules regarding these matters. It is there stated that private companies are more in the nature of partnerships than public corporations. For controlling the working of these companies it is sometimes found, necessary for the directors to take power to exclude undesirable persons as shareholders. In such companies it is usual to have provisions in the Articles of Association giving absolute discretion to the directors; and unless the power is used in 'mala fide' manners it cannot be questioned. This is what Lord Greene, M.R. with whom Luxmoore, L.J. and Asquith, J. concurred, observed :

"There is also another consideration which I think is worth bearing in mind when one comes to examine the construction of any article that falls for consideration, and that is that this type of article is one which is for the most part confined to private companies. Private companies are, of course, separate entities in law just as much as are public companies, but from the business and personal point of view they are much more analogous to partnerships than to public corporations.

Accordingly, it is to be expected that, in the articles of such a company, the control of the directors over the membership may be very strict indeed. There are very good, business reasons, or there may be very good business reasons why those who bring such companies into existence should give them a constitution which gives to the directors powers of the widest description. In the present case the article is as follows : 'The directors may at any time in their absolute and uncontrolled discretion refuse to register any transfer of shares'.

"As I have said, it is beyond question that that Is a fiduciary power, and the directors must exercise it 'bona fide' in what they consider to be the interest of the company. The language of the article does not point to any particular matter as being the only matter which the directors are to pay attention in deciding whether or not they will allow the

transfer to be registered.

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The question, therefore, is simple whether, on the true construction of the particular article the directors are limited by anything except their 'bona fide' view as to the interests of the company. In the present case the article is drafted in the widest possible terms, and I decline to write into that clear language any limitation other than a limitation, which is implicit by law, that a fiduciary power of this kind must be exercised 'bona fide' in the interest of the company subject to that qualification, an article in this form appears to me to give the directors what it says, namely, an absolute and uncontrolled discretion".

15. Judged from this test which, in our opinion, states the reasons of the law and the sense of matter, we cannot say that the learned Judge of the Court below reached a proper conclusion in all the circumstances of this case. He should have directed his attention to the question whether the action of the directors in refusing to register Shri Deshpande disclosed a lack of 'bona fides' or some oblique purpose not connected with the interests of the company or, lastly whether it was based on some wrong principle. He did not approach the question that way. He considered the action of the directors arbitrary. If the directors of the company had not given any reasons, the burden on Shri Deshpande would have been all the heavier. Fortunately for Shri Deshpande, the director's of the company in stating their reasons gave certain clue to the working of their minds. We have, therefore, to examine the reasons given together with the evidence of the Managing Director and to see whether they are valid under the Articles or 'bona fide'.

16. The evidence on behalf of the company shows that the objection to the transferee was on the ground of his being the lawyer of Sapate whose obstructive policy was considered to be prejudicial to the interests of the company. Shri Sapate was not on good terms with the management of the company. He was often quarrelling with the company and was actually fighting some cases against it. What is more significant in this context, he also joined a rival concern and applied for a permit to run buses on the very route on which the company used to ply its buses. The directors considered that the admission of the respondent to the membership of the company was against its interests. They, therefore, did not like to receive him as a member of the company.

17. The directors' decision has to be understood in the circumstances surrounding the purchase of the share by the respondent. The company was not paying dividends for four years the transferee purchased but one share in the company. In fact, Shri Sapate managed to get one share sold in the Court auction, while retaining 30 still with him and, the purchaser was no other than his lawyer. The directors probably considered that the lawyer, who was appearing for Sapate in some cases against the company, purchased just one share, though the company was not paying any dividend, probably only with a view to furthering the obstructionist policy of Shri Sapate. Nothing has been shown that the directors, in reaching the decision they did, were actuated by any considerations other than the interests of the company. It is not suggested that the decision of the directors was motivated by mere considerations of group dominance as distinguished from, what they genuinely conceived to be, the interests of the company. Having regard to all the relevant circumstances, the objection to the transferee cannot be considered to be beyond the

scope of their power under Article 20. In the absence of 'mala fides', the Court cannot substitute its own discretion in place of that which is given to the directors by the Article to refuse to register the transfer.

18. The next argument of the respondent (and which found favour with the lower Court), that the Article which the directors invoked in justification of their decision does not apply to the facts of the case at all, remains for consideration. It is contended for the respondent that a transfer in a Court sale is a transmission of the shares to the purchaser and the discretion which vests in the directors of a company to refuse to register a transfer cannot be exercised in the case of a transmission. Reliance is placed upon two decisions - '*Mohideen Pichai v. Tinnievelly Mills Co Ltd*', and - In re, Wahid Bus and Mailsi Transport Co. AIR 1949 Lahore 6. On the other hand, for the appellant reliance is placed on - '*Manilal Brijlal v. Gordon Spinning and Manufacturing Co*', and '*Nagabhushanam v. Ramachandra Rao*',

19. Before we refer to the cited cases and consider their application to the facts before us, it is necessary to point out at the very outset that in the instant case nothing can be made to turn on the distinction between a transmission, and a transfer of a share. Whether it is the one or the other, the power of the directors to refuse registration is identical and consequently the power of the Court is the same in either case. This company has adopted Articles 18 to 23 of Table A subject to the modification of Article 20 which modification we have already adverted to earlier. Article 22 of Table A deals with a case of transmission of a share when a person becomes entitled to a share in consequence of the death or insolvency of a member. Even in a case falling under Article 22, the directors have the same right to decline or suspend registration as they would have had in the case of a transfer of a share by the deceased or insolvent person before the death or insolvency". The respondent's case does not fall under Article 22 because he did not become entitled to the share in consequence of the death or insolvency of a member but on purchase at a Court auction. As the articles stand, the only way the respondent can become a member of the company is on a transfer under Articles 18 and 19 Article 18 requires that the instrument of transfer shall be executed both by the transferor and the transferee and Article 19 prescribes the form for the transfer.

20. All that is sold in a Court auction is the right, title and interest of the judgment-debtor; and where a share in a corporation is the subject-matter of the sale, Sub-Rule (3.) of Rule 79 of Order 21, Civil Procedure Code, provides that the delivery of the share shall be made by a written order of the Court prohibiting the person in whose name the share may stand from making any transfer of the share to any person except the purchaser or receiving payment of any dividend or interest thereon, and the manager, secretary or other proper officer of the corporation from permitting any such transfer or making any such payment to any person except the purchaser. With these restrictions on the shareholder it is expected that he would effect the transfer of the share in favor of the purchaser at the auction sale. If this expectation does not materialise, the purchaser is not without remedy. He can invoke the power of the Court under Sub-Rule (1) of R. 80 of Order 21, Civil Procedure Code. Under that provision, where the execution of a document-is required to transfer a share, the Judge or such officer as he may appoint in this behalf may execute such document and such execution shall have the same effect as an execution by the party. Sub-rule (2) goes on to provide the form in which the execution is to be made by the Judge of the Court on behalf of the judgment-debtor, the transferor. In view of these provisions, there is no scope for

the argument that on purchase of a share in a Court auction the purchaser automatically becomes a member of the company.

21. If there is no automatic acquisition of membership of a company by a purchaser of a share at a Court auction, as we hold there is not, the purchaser can only become a member of the company on compliance with the requirements, of Articles 18 and 19. A transfer of the share has therefore to be completed by the judgment-debtor in favour of the purchaser as required by Articles 18 and 19. Under Sub-Section (3) of section 34 of the Indian Companies Act, it is not lawful for a company to register a transfer of shares in the company unless the proper instrument of transfer duly stamped and executed by the transferor and the transferee has been delivered to the company along with the script. If the judgment-debtor refuses to execute the transfer as required by Articles 18 and 19 then the Court steps in to effectuate the transfer in favour of the purchaser. In either case, on a transfer being presented for registration to the company, the provisions of, Article 20 are necessarily attracted. We are in respectful agreement with the view of the learned Acting Chief Justice in - *'Manilal Brijlal v. Gordon Spinning and Manufacturing Co.'* (cit. sup.) that at a Court-sale the purchaser does not purchase, over and above his share, the absolute right of forcing the directors to register his name. That, as the learned Acting Chief Justice observed, "is a right which 'ex hypothesi' the Court never had to sell". Nor, if we may add, does an auction sale enlarge the rights of a shareholder. The share purchased is subject to the same incidents and restrictions as regards transfer as before the sale. In AIR 1923 Madras 241, the Division Bench agreed with the view taken in - *'Manilal Brijlal v. Gordon Spinning and Weaving Co.'* (cit. sup.) that there was still a discretion in the directors to recognize or not purchasers of shares in execution, of decrees.

22. The decision in AIR 1928 Madras 571 was that the plaintiff who purchased shares at a Court sale in execution of a decree was entitled to get his name registered forthwith and that the directors were not entitled to refuse registration of the shares in his favor. The decision was based upon a set of Articles different from those under consideration in the present case. The decision really turned upon "the contra distinction" between a transfer and a transmission of shares as made in the Articles in that case. Whether the distinction be valid or not, it was possible in that case to make that distinction and hold that the Articles concerning transfer of shares did not apply to a purchase of shares at a Court sale because of the presence of Article 29. That article provided :

"..... any person becoming entitled to shares in consequence of the death, bankruptcy, or liquidation of any member, or of the marriage of any, female member, or 'in any other way than by transfer,' shall upon procuring such evidence that he sustains the character in respect of which he proposes to act under the Clause, or of his title as the company thinks sufficient, be 'forthwith' entitled, subject to the provisions herein contained, to be registered as a member in respect of such shares, or may, subject to the regulations as to transfers hereinbefore contained transfer the same to some other person." (Underlining here into ' ' is by us).

The Court held that the discretion of the directors or the general body of the shareholders to refuse registration could not be invoked in a case falling under Article 29 but only in a case of

transfer governed by other Articles. As we have already shown, in the present case a case of purchase of shares at Court-auction cannot be kept out of the operation of Articles 18, 19 and 20.

23. In - 'In re Wahid Bus and Mailai Transport Co. (I) '(cit. sup.)' a learned single Judge of the Lahore High Court followed the decision in - '*Mohideen Pichai v. Tinnevelly Mills Co. Ltd.*, (cit. sup.) without noticing, if we may say with due respect, the special words in Article 29 in, the Madras case which furnished the basis for the decision that a purchase of a share in a Court auction was not governed by the articles relating to a transfer of a share. The Madras decision turned on its own special facts and cannot be said to give rise to any "principle" of general application as understood in the Lahore case. Further, the decision in the Lahore case also turned upon the fact that the directors accepted the transfer, agreed to register it and communicated such acceptance to the petitioner. In such circumstances, the learned Judge was of the view that they had no power to change their decision. These circumstances are not present in the case before us.

24. In the result, the appeal is allowed, the order of the District Judge is reversed and instead the application of the respondent for entering his name on the register of the share-holders of the appellant company shall stand dismissed. The respondent shall pay the costs of the appellant throughout.

Appeal allowed.

#### Cases Referred.

<sup>1</sup>(1872) 8 Ch A. 446

<sup>2</sup>(1895) 2 Ch. 404

<sup>3</sup>(1898) 14 TLR 314

<sup>4</sup>(1926) 1 Ch. 746 at p. 756

<sup>5</sup> AIR 1929 PC 13

<sup>6</sup> AIR 1932 PC 28

<sup>7</sup> AIR 1928 Mad 571

<sup>8</sup> AIR 1916 Bom 147

<sup>9</sup> AIR 1923 Mad 241