PART IV

SHARE CAPITAL AND DEBENTURES

Nature, Numbering and Certificate of Shares

S. 82. Nature of [1][*shares or debentures*].—The [1][*shares or debentures*] or other interest of any member in a company shall be movable property, transferable in the manner provided by the articles of the company.

NOTES

Eng. Act, 1948 : Sec. 73.
Eng. Act, 1985 : Sec. 182(1).

Previous Act : Sec. 28 (1).

Companies (Amendment) Act, 1999

The Companies (Amendment) Act, 1999 with effect from 31st October, 1998 has substituted the word "shares" by the words "shares or debentures". Thus the scope of this section has been extended to debentures apart from shares.

The amendment has the effect of conferring upon debentures the same status of being regarded as movable property and transferability as that enjoyed by shares.

Companies (Amendment) Act, 2000

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*].

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*].

Nature of share and right of transfer

Shares (or debentures) are movable property "transferable in the manner provided by the articles". The definition of "goods" in the Sale of Goods Act, 1930, specifically includes stocks and shares. Hence it is necessary to provide by the articles the manner in which transfers are to be effected. Where a company has no articles of its own, the regulations in Table A of Schedule I will apply. Articles cannot, however, prohibit *in toto* the right of transfer, as the right is given by the statute. Nor can the articles impose such onerous terms as affect the substance of the right to transfer so as to render it illusory. *Cf. G MO' Meara v. Benet,* AIR 1921 PC 190; *T.A.K. Mohideen Pichai Taraganar v. Tinnevelly Mills Co. Ltd.,* AIR 1928 Mad 571.

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1. Subs. for the word 'share' by the Companies (Amendment) Act, 1999 (w.e.f. 31-10-1998).

The articles of association of almost all public companies vest in the Board of Directors absolute and uncontrolled discretion to decline to register any transfer of shares (or debentures). The adoption of such an article does not mean that there is a restriction on the free transfer of shares (or debentures) as in the case of a private company. *Mathrubhumi Printing & Publishing Co. Ltd. v. Vardhaman Publishers Ltd.*, (1992) 73 Com Cases 80, 105 (DB) (Ker). This is so because a fiduciary power of this nature can only be exercised *bona fide* in the interest of the company and also within the legal framework and if it is misused, certainly the Company Law Board has the widest power to interfere with such abuse.

The rights of shareholders are:

(i) to elect directors and thus to participate in the management through them;

(ii) to vote on resolutions at meetings of the company;

(iii) to enjoy the profits of the company in the shape of dividend;

(iv) to apply to the court (CLB) for relief in the case of oppression;

(v) to apply to the court (CLB) in the case of mismanagement;

(vi) to apply to court for the winding-up of the company;

(vii) to share in the surplus on winding-up. *Life Insurance Corporation of India v. Escorts Ltd.*, (1986) 59 Com Cases 548 at 618 : AIR 1986 SC 1370; *Hindustan Lever Employees' Union v. Hindustan Lever Ltd.*, AIR 1995 SC 470; *S. Viswanathan v. East India Distilleries & Sugar Factories Ltd.*, (1957) 27 Com Cases 175 : AIR 1957 Mad 341. It is by virtue of these enforceable rights that in English law a share is regarded as a chose-in-action. *R. v. Williams*, (1942) 2 All ER 95, 103; *VGM Holdings Ltd., Re*, (1942) 1 All ER 224 : (1942) 12 Com Cases 254. But in India a share is not merely a chose-in-action; it is also by virtue of the definition of share (or debentures) in S. 82 of the Companies Act as "movable property", S. 2 of the Sale of Goods Act, 1930 includes, "shares and stock" in movable property. Therefore, shares (or debentures) become equivalent to "goods". *Hindustan Lever Employees' Union v. Hindustan Lever Ltd.*, (1995) 83 Com Cas 30; AIR 1995 SC 470 : (1994) 4 Comp LJ 267 (SC); *Kunhunni Elaya Nayar v. P.N. Krishna Pattar*, (1942) 12 Com Cases 180 (Mad). But shares are not equivalent to goods before their allotment. An applicant for allotment of shares is a prospective investor. He is not an immediate buyer of goods and, therefore, he is not in the category of a consumer within the meaning of the Consumer Protection Act, 1986. The Consumer Redressal Forum cannot entertain his complaint *Sakthi Sugars Ltd. v. District Consumer Grievances Redressal Forum*, 2000 CLC 1283 (Mad).

Where the articles do not provide for the transfer of shares (or debentures), and also expressly exclude the application of the regulations in Table A to the company, the general law relating to transfer of movable property will govern. But though for purposes of transfer, a share (or debenture) is to be treated as movable property, it is not, in fact, just so much a chattel as a garment or a piece of furniture. It is bound inextricably with the company of whose share capital it is a share and carries certain rights and obligations inseparable from the company. *Hindustan Investment Corporation v. CIT*, (1955) 25 Com Cases 57, 66, 67 (Cal).

A 'share' is a right to a specified amount of the share capital of a company, carrying with it certain rights and liabilities, while the company is a going concern and in the winding-up. It represents the interest of the holder measured for purposes of liability and dividend by a sum of money. *Borland's Trustee v. Steel Brothers Co. Ltd.*, (1901) 1 Ch 279; *Paulin (Sir William Thomas), Re*, (1933) 1 KB 26. Explaining the nature of share in *C.A. Pacific Finance Ltd. Re*, (2000) 1 BCLC 494, the court said : It is well established that shares are simply bundles of intangible rights against the company which had issued them. Share certificates are not valuable property in themselves—they are just *evidence* of the true property, which are the proportionate interests of the shareholders in the ownership of the company. One *pari passu* share is exactly the same as another. This was

recognised in *Solloway v. McLaughlin*, (1937) 4 All ER 328 : (1938) AC 247, where the Privy Council held that the broker should have retained an equivalent quantity of stock in its possession. Therefore, each share certificate with the depositary evidences the same bundle of rights, and each bundle of rights can satisfy the client's proprietary interest as any other." See also *Hunter v. Moss* (1993) 1 WLR 934 (in the Chancery Division), (1994) 3 All ER 215, (1994) 1 WLR 452 (in the Court of Appeal) and *Re Harvard Securities Ltd. (in liq), Holland v. Newbury*, (1997) 2 BCLC 369.

In the case of a company which was in existence on 1st April, 1956 and which had adopted the Regulations in Table A of Schedule I of the Companies Act (VII of 1913), the provisions in those Regulations relating to the transfer of shares would apply; and nothing in this Act inconsistent with such Regulations can affect their application (*vide* section 657).

A company cannot refuse to accept transfer of shares (or debentures) except as provided by its articles. It is well settled that unless the articles otherwise provide, a shareholder has a free right to transfer his shares to whom he chooses. It is not necessary to look to the Articles for a power to transfer, since that power is given by the Act. It is only necessary to look to the Articles to ascertain the mode of transfer and the restriction upon it. *Sadashiv Shanker Dandige v. Gandhi Seva Samaj Ltd.*, (1958) 28 Com Cases 137 : AIR 1958 Bom 247; *Vardhman Publishers Ltd. v. Mathrubhumi Ltd.*, (1991) 71 Com Cases 1, 30 (Ker). Thus, a clause in the articles providing an absolute restriction on transfer is void. A right of pre-emption in favour of certain persons is a valid restriction. *Ontario Jockey Club v. Samuel McBride*, 1927 AC 916 : AIR 1928 PC 291.

Where the articles of a company regulated the manner of transfer of shares (or debentures) by providing that it could be done with the consent of directors it was held that when only two directors were in office and the sale was by one to the other an implied consent could be presumed. *Surjit Malhan and B.K. Malhan v. John Tinson and Co.*, ILR 1985 HP 135, 167, 168.

Whether under the Companies Act or the Transfer of Property Act, the shares are transferable like any other movable property. Restrictions on transferability are valid only if contained in the company's articles. A private agreement between some shareholders which contains additional restrictions on transferability is not binding either on the company or on its shareholders. *Rangaraj (V.B.) v. V.B. Gopalkrishnan*, (1992) 73 Com Cases 201 (SC). The Supreme Court said: "Dealing with "restrictions on transfer of shares" in PENNINGTON'S COMPANY LAW, 6th edition, at page 753, it is stated that shares are presumed to be freely transferable and restrictions on their transfer are construed strictly and so when a restriction is capable of two meanings, the less restrictive interpretation will be adopted by the court. It is also made clear that these restrictions have to be embodied in the articles of association." (at page 207) Accordingly the Court held that an agreement between two members outside the articles restricting the right of transfer within family fold was held to be not binding on the company and its members.

Restrictions emanating from any other source than articles would neither cripple the company from accepting a transfer nor deprive the shareholder of his right of transfer. This conclusion was arrived at by the Supreme Court in *Gujarat Bottling Co. Ltd. v. Coca-Cola Co.*, (1995) 84 Com Cases 618 (SC). There was a franchise agreement between a soft drink manufacturer and a bottling company. One of the stipulations in the grant of the franchise was that the manufacturing company would have the right to stop supply of the concentrate if the bottling company's shares were so transferred as to result in a transfer of control. This stipulation was held to be not binding on the company's shareholders. It was not a restraint on the shareholders' right to transfer. The company's articles did not reflect any such restriction. The stipulation was supposed to govern only the relations between the parties, namely, the two companies involved, and the shareholders were not the parties to the agreement.

In *Rajesh Kumar Maheshwari v. Union of India*, (1992) 73 Com Cases 155, 166 : AIR 1992 Del 68 LEILA SETH J observed : "we are not aware of any law which compels the existing members to transfer their shareholding to the public generally. The existing

members are full owners and are perfectly entitled to transfer their shares to persons of their choice." **Affirmed** by the Supreme Court in *Om Prakash Poplai and Rajesh Kumar Maheshwari v. Delhi Stock Exchange Assn. Ltd., Union of India and Kamlesh Kumar Jain,* (1994) 79 Com Cases 766 (SC).

Shares (or debentures), being movable property, can either be mortgaged or pledged. Whether a particular transaction is a mortgage or pledge has to be decided on the intention of the parties as evidenced by the circumstances. *Arjun Prasad v. Central Bank of India,* AIR 1956 Pat 32. A legal mortgagee of shares has an implied power of sale if the mortgagor fails to pay the mortgage debts within a reasonable time. *Deverges v. Sandeman, Clark & Co.,* (1901) 1 Ch 70, on appeal (1902) 1 Ch 579; *Stubbs v. Slater,* (1910) 1 Ch 632. Shares can be validly pledged by a mere deposit or delivery of the share certificates unaccompanied by a transfer form. *Arunachalam (A.M.P.) v. Krishnamurthy (A.R.),* (1979) 49 Com Cases 662 (Mad); *Kunhunni Elaya Nayar v. Krishna Pathar,* (1942) 12 Com Cases 180, 184 (Mad). A depositee of share certificates by way of security is entitled to an order for transfer and foreclosure. *Harrold v. Plenty,* (1901) 2 Ch 314. See also *Shahzadi Begum Saheba v. Girdharilal Sanghi,* AIR 1976 AP 273, where all other Indian and English authorities are reviewed.

As between buyer (transferee) and seller (transferor) of shares, the buyer is entitled to all dividend declared after the contract of sale, unless otherwise agreed. Whatever may be the agreement, a transfer of shares after declaration of dividend, does not, as against the company, carry the dividend, even though the transfer may be cum-dividend. *Chunilal K. Patel v. H.K. Adhyaru,* (1956) 26 Com Cases 168 : AIR 1956 SC 655.

"Other interest of member"

Apart from shares, section 82 enables members to transfer their "any other interest" in the company by complying with the requirements of the company's articles. In the absence of any specific provision in the company's articles, a member can transfer his interest in the company to a third person. A guarantee company can have in its articles of association special provisions for transfer of membership interest. Acceptance by the company apart, a member may transfer his interest and that would not violate either section 82 or 108. There can be special provisions in the articles of a guarantee company about suspension of membership, resignation, nomination and assignment of interest. Their consistency with provisions of Table C of Schedule I is not necessary. Such provisions would be valid and no transfer would be possible without complying with them. *Saroj Maloo (Smt.) v. Magadh Stock Exchange Assn.,* (1995) 4 Comp LJ 135 (CLB—Cal).

Locality or situs of shares

Shares (or debentures) are for most purposes to be regarded as situate in the country in which the register upon which they are registered is kept. *Re, Clarke, McKechnie v. Clarke,* (1904) 1 Ch 294; *Brassard v. Smith,* (1925) AC 371; *London and South American Investment Trust v. British Tobacco Co. (Australia),* (1927) 1 Ch 107, 119; *Re, Aschrott, Clifton v. Strauss,* (1927) 1 Ch 313; *Baelz v. Public Trustee,* (1926) Ch 863. The dispute as to the ownership of shares (or debentures) should be determined by the *lex situs,* which will normally be the law of the place where the company, whose shares (or debentures) are the subject of the dispute, was incorporated—*Macmillan Inc. v. Bishopsgate Investment Trust plc. (No. 3),* (1995) 1 CLY 693 (CA). Where a company has more than one transfer office and it is necessary to decide by reference to which of such offices the *situs* of any of the company's shares (or debentures) must be ascertained, that office must be selected where having regard to the circumstances those shares (or debentures) can, in a business sense, be effectively dealt with. *R. v. Williams,* (1942) 2 All ER 95; *Ontario Treasurer v. Blonde,* (1947) AC 24; *Standard Chartered Bank Ltd. v. IRC,* (1978) 3 All ER 644 (Ch D). 'Effectively dealt with' here means, not as between transferor and transferee but as between the holder and the company, so that the transferee will become legally entitled to all the rights of a member, *R. v. Williams,* (1942) 2 All ER 95 at 103. See BUKLEY'S ON THE COMPANIES ACTS, 203 (14th Edn. Vol. I). As the transfer of shares (or debentures) in a company can be effected only by a change in

the register of members, the place where the register is required to be kept (see section 163) determines the *situs* of the shares (or debentures), *Erie Beach Co. Ltd. v. Attorney-General of Ontario,* 1930 AC 161 : AIR 1930 PC 10; *Brassard v. Smith,* (1925) AC 371. **Relied** on in *R. Viswanathan v. R. S. Abdul Wajid,* AIR 1963 SC 1. Two views have been maintained:

(a) the place of 'residence' of the company in which the shares (or debentures) are held determining the *situs* of the shares; and

(b) the *situs* of the shares (or debentures) is where the share register of the company is kept. *Releigh Investment Company Ltd. v. G.G. in Council,* (1943) 13 Com Cases 265, 300 (Cal–FB).

Where the shares of a member became an evacuee property and the registered office of the company was at Calcutta and the factory at Champaran in Bihar, it was held that *situs* of the shares was at Calcutta and the custodian of Bihar had no jurisdiction to take proceedings for a declaration that the shares had become evacuee property. *Muhammad Hanif v. Custodian of Evacuee Property,* AIR 1957 Patna 312.

Freedom to determine denomination of shares

§ See Notes under section 13 *ante.*

[1][**S. 83. Numbering of shares.**—Each share in a company having a share capital shall be distinguished by its appropriate number:

Provided that nothing in this section shall apply to the shares held with a depository.]

NOTES

Eng. Act, 1948 : Sec. 74. Previous Act : Sec. 28(2).
Eng. Act, 1985 : Sec. 182(2).

Depositories Act, 1996 and Depositories Related Laws (Amendment) Act, 1997

Section 83 was omitted by the Depositories Act, 1996 because shares held with a depository are not to be distinctively numbered. Subsequently, this section was restored to its position by the Depositories Related Laws (Amendment) Act, 1997 as most of the companies and shareholders have not adopted the depository mode. As per Amendment Act of 1997, the proviso was also added to this section.

The section is applicable to all cases excepting those where shares are held in a depository.

Companies (Amendment) Act, 2000

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*]

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1. Sec. 83 has been inserted by Depositories Related Laws (Amendment) Act, 1997 (w.e.f. 15-1-1997). Earlier to this, Sec. 83 was omitted by the Depositories Act, 1996 (w.e.f. 20-9-1995). Before its omission section stood as under:
'**S. 83. Numbering of shares.**—Each share in a company having a share capital shall be distinguished by its appropriate number.'

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*].

Scope of section

Each share in a company having a share capital must have a distinctive number, for identification purpose. The share certificate states the distinctive number of the shares held by the member, and a record thereof is maintained in the Register of Members.

This requirement does not apply to the shares held with a depository.

§ See also Notes under section 84 which deals with certificate of shares.

S. 84. Certificate of shares.—[1][(1)] A certificate, under the common seal of the company, specifying any shares held by any member, shall be *prima facie* evidence of the title of the member to such shares.

[2][(2) A certificate may be renewed or a duplicate of a certificate may be issued if such certificate—

(a) is proved to have been lost or destroyed, or

(b) having been defaced, or mutilated or torn is surrendered to the company.

(3) If a company with intent to defraud renews a certificate or issues a duplicate thereof, the company shall be punishable with fine which may extend to ten thousand rupees and every officer of the company, who is in default shall be punishable with imprisonment for a term which may extend to six months, or with fine which may extend to [3][*one lakh rupees*] or with both.

(4) Notwithstanding anything contained in the articles of association of a company, the manner of issue or renewal of a certificate or issue of a duplicate thereof, the form of a certificate (original or renewed) or of a duplicate thereof, the particulars to be entered in the register of members or in the register of renewed or duplicate certificates, the form of such registers, the fee on payment of which, the terms and conditions, if any (including terms and conditions as to evidence and indemnity and the payment of out-of-pocket expenses incurred by a company in investigating evidence) on which a certificate may be renewed or a duplicate thereof may be issued, shall be such as may be prescribed.][4]

NOTES

Eng. Act, 1948 : Sec. 81.
Eng. Act, 1985 : Sec. 186.

Previous Act : Sec. 29.

Companies Act, 1956

This section was initially based on clause 78 of the Companies Bill, 1953, which in turn was founded on Section 29 of the previous Act.

Companies (Amendment) Act, 1960

Based on the recommendation of the Companies Act Amendment Committee, 1957, this section was amended *vide* clause 24 of the Companies (Amendment) Bill, 1959 and

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1. Section 84 renumbered as sub-section (1) by the Amending Act 65 of 1960, s. 25.
2. Sub-sections (2) to (4) inserted by Act 65 of 1960, s. 25.
3. The words "ten thousand rupees" substituted by the Company (Amendment) Act, 2000 (53 of 2000), s. 35 (w.e.f. 13-12-2000).
4. Companies (Issue of Share Certificates) Rules, 1960, see, *Appendix* 14.

as redrafted by the Joint Committee. The amendment, in main, was aimed to prevent fraudulent dealings with duplicate shares.

Depositories Act, 1996

As per the Depositories Act, 1996 all the securities under depository mode shall be in fungible form. The share certificate shall be surrendered to the issuer company which will cancel the same and substitute in its record the name of the depository as a registered owner. In turn, the depository shall enter the name of the shareholder in its records as the beneficial owner. However, share certificates will continue to be in vogue in case of shares not covered by depository mode.

Companies (Amendment) Act, 2000

Penalty enhanced.—The Amendment Act of 2000 enhanced the penalty amount from 10,000 rupees to 1,00,000 rupees under sub-section (3).

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*]

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*].

Share certificate to be under common seal

For a certificate to be evidence of title of any member to the shares it must bear the common seal of the company and must specify the shares held by the member. The mode of specifying contemplated is to distinguish the shares by their numbers (see section 83).

It may be noted that there is no provisions under the Act relating to debenture certificates. However, the basic provisions of section 84 will also apply to the debenture certificates.

Significance of share certificate and its evidentiary value.

Companies are obliged by S. 113 to issue to the allottees and transferees a document known as a certificate of shares, to the effect that they are holding a certain number of shares of the company showing their nominal and paid-up values and distinctive numbers. This certificate is the only documentary evidence of title in the possession of shareholders. *Societe Generale De Paris v. Walker,* (1885) 11 AC 20, 29 (HL). Apart from equities, it confers upon the holder a title to the shares for all legal dealings and purposes. *Shropshire Union Rly. and Canal Co. v. R.,* (1875) LR 7 HL 496, 509.

It is not a negotiable instrument or a warranty of title by the company issuing it. *Longman v. Bath Electric Tramways Ltd.,* (1905) 1 Ch 646 (CA). As against the company it constitutes a marketable title in the hands of shareholder and prevents the company from disputing that title by what is popularly known as estoppel against the company.

Estoppel as to title

Certificates are a great convenience to shareholders and persons dealing with them, because they are *prima facie* evidence of the title to the shares. Moreover, the company is bound by its statement in the certificate, and if the statement is untrue, whether intentionally or accidentally, any person acting on it (*e.g.* advancing money, or buying the shares) can compel the company to make good its statement and pay compensation for any damage caused by reason of any misstatement.

The convenience of a certificate is that the shareholder who wants to sell or mortgage his share can at once produce it as evidence of his title, and of the amount paid up. There is no need, as in the case of real and leasehold property, to go into a history of the property, and consider who were the previous owners. The certificate is sufficient. As, however, the regulations very commonly give the company a lien, and restrict the right of transfer, and as a transfer may have been restrained by order of the court or the directors may refuse to register the transfer, a buyer or mortgagee before parting with his money will do well to ascertain that there is no impediment as to transfer.

A buyer of shares should remember that his safety depends on his acting on a certificate from the company, that is, seeing his seller's certificate, and paying his money on the faith of that, or acting on the certificate issued to himself—*e.g.*, by selling or mortgaging his shares on the faith of such certificate. In either case the company having invited the buyer to rely on the certificate, is estopped from denying his title, and will have to pay damages if the certificate is incorrect, and the shares are taken away, unless the buyer knew the certificate was incorrect. (Extracts from PALMER'S COMPANY GUIDE, 36th Edn., pages 40, 41). See also *Re, Bahia and San Francisco Rly. Co.*, (1868) LR 3 QB 584. The estoppel as to title arises in favour of any person who has entered into a transaction or has refrained from entering into it on the faith of certificate and not knowing that it carried any untrue statements. *Balkis Consolidated Co. v. Tomkinson*, (1893) AC 396 (HL); *Bloomenthal v. Ford*, (1897) AC 156 (HL); *Dixon v. Kennaway & Co.*, (1900) 1 Ch 833; *Burkinshaw v. Nicholls*, (1878) 3 App Cas 1004 (HL); *Shaw v. Port Philip Gold Mining Co.*, (1884) 13 QBD 103; *Monarch Motor Car Co. v. Pease*, (1903) 19 TLR 148; *Cf. Simm v. Anglo-American Telegraph Co., Anglo-American Telegraph Co. v. Spurling*, (1879) 5 QBD 188 (CA); *Re, Railway Time Tables Publishing Co., ex p., Sandys*, (1889) 42 Ch D 98 (CA).

Estoppel as to payment

Another kind of *prima facie* evidence which arises from the share certificate is that the company cannot dispute the amount mentioned on the certificate as already paid-up. *Bloomenthal v. Ford*, (1897) AC 156 (HL). A company can, however, show as against the allottee that the consideration which he gave to the company has failed or that the consideration was illusory. Questions of estoppel can arise only when share certificate has been transferred to a *bona fide* buyer for value. *State of Rajasthan v. Bundi Electric Supply Co. Ltd.*, AIR 1970 Raj 36.

A person who lends money to a company on the terms of a security being given to him in the shape of fully paid shares which are allotted and registered, the company will be estopped from asserting against him any liability in respect of these shares. *Bloomenthal v. Ford*, (*Supra*).

Where shares are issued as fully paid and there is no fraud in the transaction on the part of the holder, the company would be under an estoppel as to payment after a long period of time or after the allottee has obtained, on the security of the shares, loans from a financial institution so that the latter is in possession in goodfaith and for value. *Farooq Ahmed (K Md) v. Fortran Cirkit Electronics P. Ltd.*, (1998) 92 Com Cases 498: (1997) 2 Comp LJ 234 (CLB—SB). Where bonds were allotted and the allottee was given the letter of allotment and he transferred the same to a *bonafide* purchaser for value, the company was not allowed to say against such a purchaser that it had not received the payment and, therefore, had the right to forfeit the bonds for being an unpaid seller. *Canara Bank v. National Power Grid Corpn. Ltd.*, (2003) 48 SCL 543 : (2004) 58 CLA 54 (CLB).

Good faith of the transaction

The test in all cases of estoppel is whether the shares were taken honestly on the faith of the certificate and, if so, whether the holder afterwards acted honestly on the faith of the certificate or relied on it to detriment. *Hart v. Frontino and Bolivia South American Gold Mining Co. Ltd.*, (1870) LR 5 Exch 111; *Dixon v. Kennaway & Co.*, (*Supra*).

There is no estoppel where a person knew or ought to have known the reality. *Blyth's* case, (1876) 4 Ch D 140, 142 (CA); *Simm v. Anglo-American Telegraph Co., (Supra), Re, Vulcan Ironworks Co.,* (1885) WN 120.

Where a certificate was given to a firm and it was signed by a director who was also a partner in the firm the court said that the firm could have had the benefit of estoppel by proving that the director did not, at the time of signing, know the true facts. *Coasters Ltd., Re,* (1911) 1 Ch 86. It should also be noted that a company will be bound by a document issued on its behalf only if those who signed had a real or apparent authority in the matter. Where the company is estopped from denying as against a holder without notice that the shares were fully paid, any person who acquires the shares from such a holder can claim estoppel though he might have known that the shares were not fully paid. *Barrow's* case, (1880) 14 Ch D 432 (CA).

No estoppel by payment of dividend

A company is not estopped from denying the purchaser's title by the mere fact that it has treated him as a shareholder by sending him a dividend warrant. *Foster v. Tyne Pontoon and Dry Docks Co. and Renwick,* (1893) 63 LJ QB 50.

No estoppel through forged certificate

A certificate obtained through forgery does not constitute any estoppel against the company. *Simm v. Anglo-American Telegraph Co.,* (1879) 5 QBD 188 (CA) and also under forged signature. *Ruben v. Great Fingall Consolidated,* (1906) AC 439 (HL) (secretary forging director's signature). This would also be so where the company's seal is affixed without authority even though the signatures of the attesting director and of secretary may be genuine. *South London Greyhound Racecourses Ltd. v. Wake,* (1930) All ER Rep 496 : (1931) 1 Com Cases 420. Where, however, the certificate is issued under the authority of the directors it may in circumstances estop the company even if the directors' authority is obtained by fraudulent contrivances on the part of the secretary. *Dixon v. Kennaway & Co.,* (1900) 1 Ch 833.

Damages against company for wrong certificates

A person who innocently suffers damage by acting on the faith of a share certificate issued by the company may recover compensation for his loss. The measure of damages is the value of the shares at the time of the refusal by the company to recognise him as a shareholder together with interest from that date. *Re, Bahia and San Francisco Rly. Co.,* (1868) LR 3 QB 584; *Hart v. Frontino and Bolivia South American Gold Mining Co. Ltd.,* (1870) LR 5 Exch 111; *Re, Ottos Kopje Diamond Mines Ltd.,* (1893) 1 Ch 618 (CA); *Balkis Consolidated Co. v. Tomkinson,* (1893) AC 396 (HL).

In the same way if a person by reason of his reliance on a certificate loses his remedy against a third person he may recover damages from the company. But it is necessary that he should have altered his position on the faith of the certificate. *Dixon v. Kennaway & Co., (Supra); Simm v. Anglo-American Telegraph Co., (Supra).*

Liability of directors

Where directors issue a certificate of title to shares or stock which do not in fact exist or which the company has no power to issue, they may be held personally liable in damages on an implied warranty of authority to any person who acts on such certificate. *Firbanks' Executors' v. Humphreys,* (1886) 18 QB D 54. Where the directors issued shares at a discount but issued certificates stating that the shares were fully paid, the company was estopped from disputing this, but the directors were held liable to compensate the company. *Hirsche v. Sims,* (1894) AC 654.

Split certificate

A split certificate means a separate certificate claimed by a shareholder for a portion of his holding. A shareholder has the right to multiply his certificates in respect of the total number of shares held by him as per Rule 4(2) of Companies (Issue of Share Certificate)

Rules, 1960. But articles may as prescribed by the rules prescribe additional fee for obtaining each split certificate. Such a certificate may become necessary where, *e.g.*, a trustee is holding shares in the same company under different trusts. The advantage to the shareholder may be in terms of transferring by way of sale or mortgage shares in small lots. See, *Sharpe v. Tophams Ltd.*, (1939) 1 All ER 123 : (1939) 9 Com Cases 239 (CA).

Companies (Issue of Share Certificates) Rules, 1960

One of the effects of the Rules stated in Companies (Issue of Share Certificates) Rules, 1960 is that the decision for issue of a share certificate or duplicate thereof has to be that of the Board of Directors or a committee of directors consisting of not less than three directors where the directors exceed six in number and not less than two where they do not exceed six. The Company Law Board has held that a company cannot change this requirement of quorum and the decision of a committee when quorum is not present would not be in accordance with the law. *Tracstar Investments Ltd. v. Gordon Woodroffe Ltd.*, (1996) 87 Com Cases 941 (CLB—SB).

Signature on share certificates

Explanation to Rule 6 of the Companies (Issue of Share Certificates) Rules, 1960 provides that the two directors who are required to sign the share certificate may do so by way of machine or other mechanical means. However, the Secretary or other authorised person, also required to sign the certificate, is not allowed to do so. The Department has clarified that the intention of this requirement is that there must be at least one signatory who signs in person so as to verify that everything is all right [*Company News & Notes*, 1 July, 1963]. On the basis of the above clarification, it seems that the other person authorised by the 'Board' who is required to sign the share certificate besides the two directors, may himself be a director of the company. Because the only intent of this requirement is that whereas the two directors may sign by way of printed signature, and last being either the Secretary or other authorised person must sign by his own pen.

Departments' Clarification.—Affixing of signature by means of machine on share certificates

Query : Under the provisions of the Companies (Issue of Share Certificates) Rules, 1960, a director may sign a share certificate by affixing his signature thereon by means of any machine, etc. Whether this provision was applicable to both the directors who are required to sign the share certificates or only to "a director" and whether there was any significance why the secretary was not permitted to affix his signature by means of any machine, etc., as is allowed in the case of a director?

Answer : The Department's reply to the above query is that both the directors can avail of the facility of using machine for affixing the signature in accordance with the terms and conditions mentioned in the said Rules. The reason why the secretary also is not permitted to avail the same facility is that there should at lest be someone belonging to the board of directors to exercise due check and take responsibility that everything is all right. [*Company News & Notes, July 1, 1963 issue*].

Number of share certificates to be issued

Neither section 84 nor section 113 nor the Companies (Issue of Share Certificates) Rules provide for the number of share certificates to be issued to a shareholder. This may be dealt with by the articles of association of the company. Regulation 7 of Table A provides that every member is entitled to one certificate for all shares without payment and several certificates each for one or more of shares upon payment of one rupee for every certificate after the first. Where the shares are dealt on any recognised Stock Exchange, the listing agreement will provide for issue of share certificates or splitting up of share certificates for shares in marketable lots without payment of fees. SEBI Guidelines, 2000 lays down the requirements for issue of security certificates in tradeable or odd lots.

SEBI Guidelines, 2000—Issue of Certificates in tradeable lots

The successful applicants shall be issued by the issuer company share certificates/instruments for eligible number of shares in tradeable lots.

The minimum tradeable lot, in case of shares of face value of Rs.10/- each, shall, at the option of the issuer/offeror, be fixed on the basis of offer price as given below. However, the maximum tradeable lot in any case shall not exceed 100 shares:

Offer price per share	*Minimum Tradeable lot*
Upto Rs 100	100 Shares
Rs 101- Rs 400	50 Shares
More than Rs. 400	10 Shares [Clause 8.6.1 (iii) and (iv)]

Issue of Certificates in odd lots.—Whenever any issue results in issue of shares in odd lots, the issuer company, shall as far as possible issue certificates in the denomination of 1-2-5-10-20-50 shares [*Clause 6.5.2.3*].

Issue of securities in dematerialised form—See clause 2.1.5.1 of the Guidelines and Notes under sec. 56.

Inscription of non-transferability.—The securities which are subject to lock-in shall carry inscription 'non-transferable' along with duration of specified non-transferable period mentioned in the face of the security certificate [*Clause 4.17.1 of Chapter IV*].

Initial public offer.—In case of public issues by unlisted companies, the lead merchant banker shall incorporate a statement in the offer document that the trading in the securities shall be in dematerialised form only for all investors. [*Clause 6.34(c) of Chapter VI*]

SEBI Circular No. 12/01, dated 28-2-2001.—SEBI has mandated that all the shares allotted under new initial public offerings (IPOs) will be traded in demat form only in all the exchanges. Investors, however, have the right to obtain and hold physical share certificate, though these will need to be dematerialised before sale of securities. Currently, the listing agreement provides that the physical share certificates are to be issued in market lots only [*clause 4(a)*]. It has now been decided that in the case of IPOs the issuer company may issue a single share certificate to any investor who wishes to obtain physical share certificates unless otherwise specifically requested by him. [*SMDRP/Policy/Cir-12/01 dt. 28-2-2001, issued by the Secondary Market Department.*]

Standardisation of size of share certificates dispensed with

The Central Government, had notified *vide* Notification GSR 562(E), dated 19-8-1993 that the share certificates were to be printed on paper of uniform size having length of 297 mm and width of 210 mm. But by Notification No. GSR 597(E), dated 28-7-1994 the requirement as to size has been withdrawn w.e.f. 28-7-1994.

Press Note, dated 27-7-1994.—1.The Department of Company Affairs issued Gazette Notification No. 562(E), dated 19th August, 1993 for standardising the size of the share certificates as 297 mm x 210 mm. However, this move to prescribe a standard size for share certificates has created more problems for companies than it has solved. A number of representations have been received from different quarters including trade associations, companies, professional institutes suggesting different sizes of share certificates, as also for the use of existing stock. It has also been represented that the computer printers available in the country have been designed to print certificates to a maximum size of 12" (length) and 15" (width) for 2 ups as against 12" (length) and 16.5" (width) for 2 ups as stipulated in the notification. In view of the difficulties faced by the industry and considering that the size of share certificate in any case is regulated by the stock exchanges in the case of listed companies as per listing guidelines, it has now been decided to withdraw the notification issued in August last year.

Clean certificate

A member is entitled to a clean certificate. It means a certificate which does not contain any derogatory remark to his title. *W. Key & Son Ltd., Re,* (1902) 1 Ch 467.

Duplicate certificate [Sub-section (2)]

The right to obtain duplicate certificate for the original which has been lost or become mutilated is conferred by Sec. 84(4) and same is issued in accordance with Rule 4(3) of

the Companies (Issue of Share Certificate) Rules, 1960. For text of Rules, see, Notes under section 113.

Once a duplicate certificate is issued, the original certificate becomes extinct. In order to safeguard the original shareholder from any jeopardy, it is necessary under sub-s. (2)(a) that there is proof of the fact that the original has been lost or destroyed. It has been held by the Company Law Board that the original cannot be said to have been lost or destroyed as long as the existence of the original is known. Hence, as a matter of precaution public notice of the loss must be given whenever duplicate certificate is sought. This will be more particularly necessary where a substantial number of share certificates is involved. No company should take this precaution lightly. An issue of duplicate certificates was held to be not in accordance with section 84(2) where the precautions prescribed by the sub-section for ascertaining genuineness of loss were not observed. The purpose of the sub-section is to safeguard the share market from fraudulent dealings in duplicates. *Tracstar Investments Ltd. v. Gordon Woodroffe Ltd.*, (1996) 87 Com Cases 941 (CLB—SB). A Division Bench of the Madras High Court **affirmed** this decision in *Shoe Specialities Ltd. v. Tracstar Investment Ltd.*, (1997) 88 Com Cases 471 (Mad—DB) and added at p. 504 that where matters are so extremly complicated that the directors themselves are not able to find out the reality as to the loss of documents and the genuineness of the claims for duplicates, the company should refer the matter to a decision in a regular civil suit where the truth of the matter can be ascertained to a greater certainty. The court referred to the decision in *Ammonia Supplies Corporation P. Ltd. v. Modern Plastic Containers P. Ltd.*, (1994) 79 Com Cases 163 (Del) where it was held that matters of title to shares for the purposes of transfer for which the jurisdiction is vested in the Company Law Board can still be referred to the decision of a civil court by filing a regular civil suit. The decision of the High Court of Delhi has been **affirmed** by the Supreme Court in *Ammonia Supplies Corpn. P. Ltd. v. Modern Plastic Containers P. Ltd.*, (1998) 94 Com Cases 310 (SC).

The advertisements in newspapers can be issued only upon receipt of an application by the registered shareholder or in case of his death by his heir and legal representatives stating loss of original share certificates and asking for issue of duplicate share certificates. *Prima facie* the advertisements were issued unauthorisedly in this case. Accordingly, the absence of response to such unauthorised issuance of advertisements in newspapers cannot justify such application and cannot make the issue of duplicate share certificates valid or proper particularly when the registered shareholder is alive at the time the company is considering the approval of transfer of shares by him. *Pradip Kumar Sarkar v. Laxmi Tea Co. Ltd.*, (1990) 67 Com Cases 491 at 501 (Cal). Duplicate shares were issued by transfer agents. The originals were supposed to have been either cancelled or lying with the Bombay Stock Exchange. Hence, there was no possibility of those certificates remaining in circulation and thereby causing loss to any body. Compounding was allowed subject to the permission of the prosecuting court. It was also held that the matter can be brought before such court after taking compounding from the Company Law Board. *Reliance Industries Ltd., Re,* (1997) 89 Com Cases 67 (CLB—WB).

A company and its share transfer agents were held liable to compensate the true owner whose shares were registered in the name of another person on the basis of duplicate share certificates. The company and its agents could recover their indemnity amount from the share broker who had sent in false papers on the basis of which duplicates were issued. *Royal Bank of Scotland v. Sandstone Properties Ltd.*, (1998) 2 BCLC 429 (QBD).

If the company refuses to issue a duplicate share certificate, the remedy of the aggrieved person is to file a company application in terms of Rule 9 and Rule 11(b) of the Companies (Court) Rules, 1959. The application has to be filed in the High Court and there must be a specific prayer for a direction to the concerned company to issue a duplicate share certificate. Reference can be made to the decision of the Rajasthan High Court in *Maharaj Kumar Mahendra Singh v. Lake Palace Hotels & Motels P. Ltd.*, (1985) 58 Com Cases 805 (Raj) wherein it was held that the right to inspect accounts was a statu-

tory right and could be enforced by an application to the High Court. The remedy under the Companies Act being equally efficacious, writ jurisdiction cannot be availed of for the purpose unless there are special circumstances. *United India Insurance Co. Ltd. v. Escttrac Finance & Investment Co. Ltd.,* (1998) 2 Comp LJ 94, 98 (Del).

The court will not compel a company to register a transfer and to issue share certificate or duplicate share certificate unless the applicant has established his title to the shares. *Sundaram Pillai (S.) v. P. Govindaswami,* (1987) 62 Com Cases 414 (Mad).

Delay in issuing duplicate share certificates does not by itself amounts to fraudulent conduct of the company's affairs so as to create the need for an order of an investigation of affairs under section 237. *Charanjit Singh Ghuman v. Dr. Reddy's Laboratories Ltd.,* (1997) 3 Comp LJ 141 : (1997) 13 SCL 111 (CLB—NB).

Listing Agreement requirements.—As per clause 3(e) of the Listing Agreement, new certificates in respect of those which are lost, are to be issued within 6 weeks of notification of loss and receipt of proper indemnity.

The company will not make any charge for issue of new certificates in replacement of those which are old, decrepit or worn out, or where the cages on the reverse for recording transfers have been duly utilised [*clause 8(d)*]. It will not charge any fees exceeding those agreed upon with the stock exchange for issue of new certificates in replacement of those which are torn, defaced, lost or destroyed [*clause 9(a)*].

SEBI Circular 46/2001, dated 27-9-2001.—Where the investor has complained about issuing of duplicate share certificate(s) by the company on the basis of allegedly forged/stolen documents furnished by a third party, the company shall verify and satisfy itself of the claim of the investor, within 15 days of receipt of the claim and take steps including invoking of indemnity bond to issue shares and corresponding benefits to the rightful owner in terms of section 84 of the Companies Act read with Rule 3 of the Companies (Issue of Shares Certificates) Rules, 1960.

The above decisions would be applicable in respect of all companies/organisations (*i.e.* entities) whose shares are listed on any of the Stock Exchanges and are in physical form. [*SEBI Cir. SMDRP/Policy/Cir.-46/2001, dt. 27-9-2001*].

Irregularity in procedure for issuing duplicates

Section 84 and the Companies (Issue of Share Certificate) Rules, 1960 prescribe the procedure for issue of duplicate share certificates. In the case of a closely held private company, certain procedural lapses took place in issuing duplicates. The Company Law Board felt that in the case of such a company, all the details of the company are known to all the shareholders and there is very little chance of miscarriage of justice. Therefore, the lapses in question did not affect the power of the company to issue duplicates and the right of the applicant shareholder to get them. *S. Anuratha v. AKMN Glinders P. Ltd.,* (1999) 95 Com Cases 555 (CLB—SB).

The shares of one person were in the custody of another. The company issued duplicate certificates to the original shareholder and subsequently registered their transfer in favour of others. The company did not seek any verification of the loss or destruction of the originals. The issue of duplicates was held to be in violation of Rule 4(3) of Issue of Share Certificates Rules, 1960. The requirements of the articles of the private company were also not complied with. The transfer under question was held to be void. *Stridewell Leathers P. Ltd. v. Shoe Specialities P. Ltd.,* (2001) 33 SCL 797 : (2001) 44 CLA 264 (CLB—Chennai).

Proper forum for grant of relief

In *Shripal Jain v. Torrent Pharmaceuticals Ltd.,* 1995 Supp. 4 SCC 590, the Supreme Court ordered as follows:

In this case, the share certificates purchased by the appellant in respect of Torrent Pharmaceuticals Ltd. were stolen. The appellant approached the Registrar, for issue of duplicate certificates. The Registrar

directed the appellant to have a direction in this respect from the civil court. The civil court rejected the application of the appellant. The High Court dismissed the civil revision filed by the appellant *in limine*, Supreme Court said : "We are of the view that the Registrar of the Companies was in patent error in referring the appellant to the civil court in the facts and circumstances of the present case. He should have himself held an enquiry into the matter under Section 84(4) of the Companies Act read with the Companies (Issue of Share Certificates) Rules, 1960 and taken a decision himself in the matter. We, therefore, set aside the impugned order of the civil court and consequent order of the High Court and remand the case back to the Registrar, to decide the matter in accordance with law in the first instance".

Stamp Duty on Certificates of shares

Being a State subject, the stamp duty varies from State to State. Please refer *Appendix* 113 for Table of Stamps and Fees and also K. KRISHNAMURTHY—INDIAN STAMP ACT, 8th Edn., 2002.

Stamp Duty on Duplicate Certificates.—Under Article 25, Indian Stamp Act, 1899, where stamp duty has been paid on the original instrument and the same being not available, the same amount of duty would be payable on duplicate if the duty does not exceed one rupee. The counterpart or duplicate is chargeable with duty only if the original is chargeable with duty, and proper duty has been paid on the original. If a counterpart or duplicate stamped under this Article is sought to be put in evidence, the Court would require the original to be produced, unless it bears an endorsement by the Collector under section 16 denoting the duty paid on the original. See commentary under Article 25, K. KRISHNAMURTHY, INDIAN STAMP ACT, 8th Edn., 2002.

Relevant Rules and Forms

The Companies (Issue of Share Certificates) Rules, 1960

G.S.R. 333—In exercise of the powers conferred by clause (b) of sub-section (1) of section 642 of the Companies Act, 1956 (1 of 1956), and in supersession of the Companies (Issue of Share Certificates) Rules, 1959, published with the notification of the Government of India in the Ministry of Commerce and Industry (Department of Company Law Administration) No. G.S.R. 798, dated the 30th June, 1959 the Central Government hereby makes the following rules, namely:—

1. Short title.—These rules may be called **The Companies (Issue of Share Certificates) Rules, 1960.**

2. Effect of Rules.—These rules shall have effect notwithstanding anything to the contrary contained in the Articles of Association of a company.

3. Definitions.—In these rules, unless the context otherwise, requires,—

(a) "Act", means the Companies Act, 1956 (1 of 1956).

(b) "Board" means that the Board of Directors of a company or a Committee thereof consisting of not less than three directors where the total number of directors exceeds six and not less than two directors where the total number does not exceed six:

Provided that, to the extent that the composition of the Board of Directors permits of it, at least half of the number of members of the Committee shall consist of directors other than (i) a managing or whole-time director or, (ii) [1][* * * *].

(c) "Seal" means the common seal of a company.

4. Issue of share certificates.—(1) When a company issues any capital, no certificate of any share or shares in the company shall be issued except:

(i) in pursuance of a resolution passed by the Board; and

(ii) on surrender to the company of its letter of allotment or of its fractional coupons of requisite value, save in cases of issues against letters of acceptance or of renunciation, or in cases of issue of bonus shares:

Provided that if the letter of allotment is lost or destroyed, the Board may impose such reasonable terms, if any, as to evidence and indemnity and the payment of out of pocket expenses incurred by the company in investigating evidence, as the Board thinks fit.

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1. Omitted as unnecessary as the system of managing agents and secretaries and treasurers has been abolished by Act XVII of 1969.

(2) No certificate of any share or shares shall be issued either in exchange for those which are sub-divided or consolidated or in replacement of those which are defaced, torn or old decrepit, worn-out, or where the cases in the reverse for recording transfers have been duly utilized, unless the certificate in lieu of which it is issued is surrendered to the company:

Provided that the company may charge such fee, if any, not exceeding Rs. 2 per certificate issued on splitting or consolidation of share certificates or in replacement of share certificates that are defaced or torn, as the Board thinks fit.

(3) No duplicate share, certificate shall be issued in lieu of those that are lost or destroyed without the prior consent of the Board or without payment of such fees, if any, not exceeding Rs. 2 and on such reasonable terms, if any, as to evidence and indemnity and the payment of out-of-pocket expenses incurred by the company in investigating evidence as the Board thinks fit.

[2][(4) The companies listed with OTC Exchange of India, a company registered under section 25 of the Companies Act, 1956, may issue a jumbo share certificate in favour of Custodian and issue counter receipts to every allottee with respect to their holding.

[3][*Provided* that no counter receipt shall be issued after the 28th February, 1999."]

Explanation.—For purposes of sub-rule (4), "Custodian" means an entity carrying on post-trade activities such as, settlement of purchases and sales, information reporting, safe keeping of securities and/or participating in any clearing system for and on behalf of the client to effect deliveries of the securities.]

5. Form of certificates.—(1) Every certificate shall specify the name(s) of the person(s) in whose favour the certificate is issued, the shares to which it relates and the amount paid up thereon.

(2) When any certificate is issued in any of the circumstances specified in Rule 4, sub-rule (2), it shall state on the face of it and against the stub or counterfoil to the effect that it is "Issued in lieu of share certificate No. .... Sub-divided/replaced/on consolidation of shares."

(3) When any certificate is issued in any of the circumstances specified in Rule, 4, sub-rule (3), it shall state on the face of it and against the stub or counterfoil to the effect that it is a "duplicate issued in lieu of share certificate No. ....." Further, the word "duplicate" shall be stamped or punched in bold letters across the face of the share certificate.

6. Sealing and signing of certificate.—Every share certificate shall be issued under the seal of the company, which shall be affixed in the presence of (i) two directors or persons acting on behalf of the directors under a duly registered power-of-attorney; and (ii) the secretary or some other person appointed by the Board for the purpose. The two directors or their attorneys and the secretary or other person shall sign the share certificate:

Provided that, if the composition of the Board permits of it, at least one of the aforesaid two directors shall be a person other than a managing or whole-time director [4][* * * *].

Explanation.—For the purpose of this rule, a director may sign a share certificate by affixing his signature thereon by means of any machine, equipment or other mechanical means such as engraving in metal or lithography, but not by means of a rubber stamp, provided that the director shall be responsible for the safe custody of such machine, equipment or other material used for the purpose.

7. Records of certificates issued.—(1) Particulars of every share certificate issued in accordance with rule 4, sub-rule (1) shall be entered in the Register of Members maintained in the form set out in the appendix annexed hereto or in a form as near thereto as circumstances admit, against the name(s) of person(s) to whom it has been issued indicating the date of issue.

(2) Particulars of every share certificate issued in accordance with rule 4, sub-rules (2) and (3) shall be entered in a Register of Renewed and Duplicate Certificate indicating against the name(s) of the person(s) to whom the certificate is issued, the number and date of issue of the share certificate in lieu of which the new certificate is issued, and the necessary changes indicated in the Register of Members by suitable cross-references in the "Remarks" column.

(3) All entries made in the Register of Members or the Register of Renewed and Duplicate Certificate shall be authenticated by the secretary on such other person as may be appointed by the Board for purposes of sealing and signing the share certificate under the provisions of rule 6.

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2. Ins. by Amendment Rules, 1995 *vide* GSR 423(E), dated 26-5-1995 (w.e.f. 26-5-1995).
3. Ins. by Amendment Rules, 1999 *vide* GSR 17(E) dt. 5-10-1999.
4. Omitted as unnecessary as the system of managing agents and secretaries and treasurers has been abolished by Act XVII of 1969.

8. Printing of forms.—All blank forms to be used for issue of share certificate shall be printed [5][* * * *] and the printing shall be done only on the authority of a resolution of the Board. The blank form shall be consecutively machine-numbered and the forms and the blocks, engravings, fascimiles and hues relating to the printing of such form shall be kept in the custody of the secretary or such other person as the Board may appoint for the purpose and the secretary or other person aforesaid shall be responsible for rendering an account of these forms to the Board.

9. Custody of books and documents.—(1) The following persons shall be responsible for the maintenance, preservation and safe-custody of all books and documents relating to the issue of share certificates except the blank forms of share certificates referred to in rule 8, namely:—

(a) [6][* * * *];

(b) [6][* * * *];

(c) [6][* * * *];

(d) where the company has [6][* * * *] a managing director, the managing director;

(e) where the company has no [6][* * * *] managing director, every director of the company.

(2) All books referred to in sub-rule (1) shall be preserved in good order permanently and all certificates surrendered to a company shall immediately be defaced by the word "cancelled" being stamped or punched in bold letters and may be destroyed after the expiry of three years from the date on which they are surrendered, under the authority of a resolution of the Board and in the presence of a person duly appointed by the Board in this behalf.

[7][*Provided* that nothing in this sub-rule shall apply to cancellation of the certificates of security under sub-section (2) of section 6 of the Depositories Act, 1996 (22 of 1996), when such certificates are cancelled in accordance with sub-regulation (5) of regulation 54 of Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996 made under section 30 of the Securities and Exchange Board of India Act, 1992 (15 of 1992) read with section 25 of the Depositories Ordinance, 1996 (ord. 17 of 1996).]

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5. The words "On the paper of the size having length of 297 millimetres and width of 210 millimetres" were inserted by the Amendment Rules, 1993 *vide* GSR No. 562(E), dated 19-8-1993 (w.e.f. 1-1-1994) were omitted by Amendment Rules, 1994 *vide* GSR 597(E), dated 28-7-1994 (w.e.f. 28-7-1994).

6. Omitted as unnecessary as the system of managing agents and secretaries and treasurers has been abolished by Act XVII of 1969.

7. Ins. by Companies (Issue of Share Certificates) Amendment Rules, 1996 (w.e.f. 16-10-1996).

Name
Address
Occupation
Date at which entered as a Member

APPENDIX
[See rule 7]
REGISTER OF MEMBERS

Folio No.....

Date at which ceased to be a Member

Shares acquired					Cash payable on shares			Cash paid on shares				Shares transferred										
			Distinctive number of shares inclusive													Distinctive number of shares inclusive						
No. of allotment or transfer	Date of allotment or entry of transfer	No. of shares allotted or transferred	From	To	Number and date of issue of certificate	Transferor's folio	Nominal value of shares acquired	Amounts due and on what account (allotment or call, etc.)	Date when due	Date of payment	Cash book folio	Amount paid	No. of transfer	Date of entry of transfer	No. of shares transferred	From	To	No. and date of issue of the certificate	Transferor's folio	Total nominal value of shares transferred	Balance of shares held	Remarks
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23

Note : All entries in the Register should be authenticated by the Secretary or the person appointed by the Board to sign share certificates.

Penalty for default [Sub-section (3)]

If a company with intent to defraud renews the certificate or issues duplicate thereof, the company is punishable with fine which may extend to Rs. one lakh and every officer of the company who is in default is punishable with imprisonment for a term up to six months or with fine up to Rs. one lakh or with both, under sub-section (3).

In a prosecution for failure to issue duplicate share certificates, notice was sent to the Vice President of the company. The Court said that this was not to be taken as a notice in personal capacity. The Vice President was bound to honour the summons of the Court. He was not entitled to say that he had nothing to do with the offence. The Court refused to quash the complaint. *Dhirubhai H. Ambani v. Sonia Sethi,* (2001) 106 Com Cases 486 : (2001) 3 Comp LJ 75 (MP).

Compoundable offence.—The offence is compoundable under section 621A.

ICSI Guidance Note on Compliance Certificate (August, 2003)

The ICSI has issued a Check List for issue of Compliance Certificate under proviso to Sec. 383A(1) in respect of maintenance of registers. The relevant paragraph 1 of the Form prescribed under Rule 3 of the Companies (Compliance Certificate) Rules, 2001 states :

"Paragraph 1.— **The company has kept and maintained all registers as stated in Annexure "A' to this certificate, as per the provisions and the rules made thereunder and all entries therein have been duly recorded."**

Register of Renewed and Duplicate Certificates under Rule 7 of the Companies (issue of Share Certificates) Rules, 1960

Prescribed Check List [*Item (p)*]

Check whether:

(i) the register has been maintained containing prescribed particulars, viz.; the name of the person to whom the certificate has been issued, the number and date of issue of share certificate etc.; and

(ii) all entries in the register have been authenticated by the secretary or any other person authorised by the Board of directors.

Paragraph 12 under Rule 3 relates to issue of duplicate share certificates and reads as follows:

Paragraph-12.—**The Board of directors or duly constituted Committee of directors has approved the issue of duplicate share certificates.**

ISSUE OF DUPLICATE SHARE CERTIFICATES

Prescribed Check list

Check whether:

(i) if both strength and quorum of the Committee of directors constituted under rule 3(b) of the Companies (Issue of Share Certificates) Rules, 1960, are not less than 3 directors where the total number of directors of the company exceeds 6 and not less than 2 directors where the total number does not exceed 6 and to the extent the composition of the Board of directors permits, half of the number of members of the Committee are directors other than a managing director or whole-time director;

(ii) the Board resolution for issue of duplicate share certificates has been passed;

(iii) duplicate certificates have been issued with the prior consent of the Board or Committee thereof as also in accordance with the provisions of section 84 of the Act and provisions contained in the articles of association;

(iv) the form of certificate including split/consolidated/replaced/duplicate issued conforms to rule 5 of the said Rules;

(v) certificates issued by the company comply with rule 6 of the said Rules as to affixing seal and signing of certificates;

(vi) (a) particulars of every share certificate issued have been recorded in the Register of members;

(b) particulars of every share certificate issued for split/consolidation or duplicate certificate issued are recorded in the register of renewed/consolidated and duplicate certificate issued;

(c) all entries made in the Register of members or register of renewed or duplicate certificates have been authenticated by the Secretary or such other persons as may be appointed by the Board.

(vii) the company has a good internal control system for blank form of share certificate and all certificates issued and blank stationery have been periodically accounted to the Board;

(viii) all books and documents relating to the issue of share certificates have been preserved in good order permanently;

(ix) appropriate indemnity bond and affidavit have been obtained.

(x) an advertisement was released in case articles so require.

For the text of the Companies (Compliance Certificate) Rules, 2001, see *Appendix* 38.

For the full text of the Guidance Notes on Compliance Certificate and for Specimen Compliance Certificate Form as issued by ICSI see *Appendix* 312.

Kinds of Share Capital

S. 85. Two kinds of share capital.—(1) "Preference share capital" means, with reference to any company limited by shares, whether formed before or after the commencement of this Act, that part of the share capital of the company which fulfils both the following requirements, namely:—

(a) that as respects dividends, it carries or will carry a preferential right to be paid a fixed amount or an amount calculated at a fixed rate, which may be either free of or subject to income-tax; and

(b) that as respect capital, it carries or will carry, on a winding up or repayment of capital, a preferential right to be repaid the amount of the capital paid-up or deemed to have been paid-up, whether or not there is a preferential right to the payment of either or both of the following amounts, namely:—

(i) any money remaining unpaid, in respect of the amounts specified in clause (a), up to the date of the winding up or repayment of capital; and

(ii) any fixed premium or premium on any fixed scale, specified in the memorandum or articles of the company.

Explanation.—Capital shall be deemed to be preference capital, notwithstanding that it is entitled to either or both of the following rights, namely:—

(i) that, as respect dividends, in addition to the preferential right to the amount specified in clause (a), it has a right to participate, whether

fully or to a limited extent, with capital not entitled to the preferential right aforesaid;

(ii) that, as respects capital, in addition to the preferential right to the repayment, on a winding-up, of the amounts specified in clause (b), it has a right to participate, whether fully or to a limited extent, with capital not entitled to that preferential right in any surplus which may remain after the entire capital has been repaid.

(2) "Equity share capital" means, with reference to any such company, all share capital which is not preference share capital.

(3) The expressions "preference share" and "equity share" shall be construed accordingly.

NOTES

Eng. Act, 1985 : Sec. 744

Companies Act, 1956

Scope of section

Sections 85 to 90 deal with kinds of share capital and voting rights. And they do not apply to any private company unless it is subsidiary of a public company. [Section 90]

The principles underlying these sections are: (1) that voting rights are generally confined to holders of equity share capital, preference shareholders being given right of voting only for certain purposes under certain given conditions, (2) voting rights and other rights of shareholders are to be strictly proportional to their proportionate share of the equity share capital.

Share capital is of two kinds—preference share capital and equity share capital. A preference share must satisfy the following two conditions:

(1) as regards dividends, it must carry a preferential right to a fixed amount, or an amount calculated at a fixed rate, and

(2) as regards capital, in the event of a winding-up or other arrangement to repayment of capital, there must be a preferential right to be repaid the amount of capital paid-up on such share.

These are the two dominant characteristics of preference share capital. A preference share may or may not carry such other rights as the following:—

(a) a preferential right to be paid any arrears of dividend remaining due on such share;

(b) a right to be paid a fixed premium as per the memorandum or articles;

(c) a right to share in surplus profits by way of additional dividend; and

(d) a right to share in surplus assets in the event of a winding-up, after all kinds of capital have been repaid.

Unless any shares satisfy both the conditions in clauses (a) and (b) of sub-section (1) they will not be preference shares.

All share capital, not falling within the above description of preference capital, is equity capital. The COHEN COMMITTEE (U.K.) defines 'equity share capital' as 'that part of the share capital which confers a right either to the whole or part of any residue of any profits or to the whole or part of any residue of any assets remaining for distribution after satisfying the claims of any other shareholders whose right to participate therein is limited' (*Report* : para 122, page 73).

The Joint Committee which redrafted the sections 85 to 90, gives the following explanation—"It has also been made clear in the clause that the dividend on preference shares may be either free of or subject to income-tax. The facts (a) that a preference share is entitled in addition to the preferential right to the fixed dividend to a portion of the dividend depending upon the quantum of the profit, or (b) that on a winding-up it carries in addition to the preferential right to repayment of capital a right to participate in the surplus assets after the entire capital has been paid in full will not have the effect of making the definition of 'preference capital inapplicable to the case'. (*Report* : para 40)

There must be two kinds of shares for one to be preference

The Patna High Court, has pointed out in *Bihar State Financial Corporation v. CIT, Bihar,* (1976) 46 Com Cases 155 (Pat—DB) that before there can be preference shares there must be at least two kinds of shares (equity and preference shares) in which one class is given preferential treatment over the other and the rate of dividend once being fixed to be preferentially paid to such class of shareholders. Such shareholders are not entitled to further participation in the profits. Where there was only one class of shares, there was no question of preferential treatment of one class of shareholders over another in the matter of dividends.

Rights of preference shareholders

The rights of preference shareholders, like other class rights, may be stated in the memorandum, articles or in the terms of issue. In modern practices they are normally set out in detail in the company's articles. *Old Silkstone Collieries Ltd., Re,* (1954) 1 All ER 68. "It is desirable that the rights of the preference shareholders should be stated in the articles or, if desired, in the memorandum as precisely and exhaustively as possible. This will exclude any doubt as to the nature and ambit of those rights". PALMER'S COMPANY LAW, 549 (24th Edn., 1987): para 6.104, Vol. 1, (25th Edn., 1992). Where this precaution of exhaustively stating the rights is not taken, insurmountable problems as to the ambit of their rights, particularly those relating to dividends and participation in the distribution of surplus assets, may arise. Provisions should also be inserted as to the way in which, in case of need, their rights shall be alterable. By far the most important aspects of their rights that ought to be clarified are those relating to accumulation of dividend while the company is a going concern and participation in the distribution of surplus assets in the winding up of the company.

Payment of dividend on preference shares.—As per section 205 of the Act, no dividend shall be declared or paid by a company for any financial year except out of the profits of the company for that year or out of the profits of the company for any previous financial year(s), remaining undistributed or out of the both, subject to the conditions laid down in the said section. Accordingly, a company which has incurred losses, cannot declare or pay dividend for year(s) in which losses are incurred. The company becomes liable to pay dividend on preference shares only when it declares dividend, and if in the meanwhile the preference shares are redeemed, the right of the preference shareholders to dividend, in the absence of any specific stipulation in this regard, does not continue after such redemption.

Accumulation of dividend.—Preference shareholders are a part of the company's share capital, and are not loans. Consequently it follows that whatever be their specified rate of dividend, the only source out of which they can be paid is distributable profits. *M.F.R. D'Cruz v. K.N. Vishwanathan,* (1941) 11 Com Cases 277 : AIR 1941 Mad 806. So the preference shareholders cannot ask for payment unless there are sufficient profits and a dividend has been declared in accordance with the framework of the statutory provisions and those in the company's articles. *Bond's Barrow Haematite Steel Co., Re,* (1902) 1 Ch 353; *Accrington Corpn. Steam Tramways Co., Re,* (1909) 2 Ch 40. It makes no difference if the articles provide that preference dividend shall be payable without declaration. This may at the most dispense with declaration at a general meeting. A declaration by the directors would still be necessary. *Buenos Ayres Great Southern Ry. Co. Ltd., Re,* (1947) 1 All ER 729. Once a preference shareholder receives his preference

dividend in a particular year, he cannot ask for anything more, though the directors may declare more than one dividend in a year for the ordinary shareholders. *Steel Company of Canada Ltd. v. Ramsay,* (1932) 2 Com Cases 23 (PC). If owing to lack of profits in one year or directors' decision that profits shall not be distributed in that year, the preference shareholders remain partly or wholly unpaid, the question arises whether the unpaid dividend will lapse or accumulate so as to be payable out of the succeeding years' profits. If the right to dividend lapses, the shares are called non-cumulative preference shares and, if the dividend will go on accumulating, they are called cumulative preference shares. Whether they are of one category or the other, depends upon the terms of issue. But unless there is a term against accumulation, preference shares are presumed to be cumulative. *Henry v. Great Northern Ry. Co.,* (1857) 1 De G & J 606; *Webb v. Earle,* (1875) LR 20 Eq 556; *Fraser v. Coles,* (1906) 22 TLR 555. The presumption of accumulation can be ruled out only by a very carefully drafted clause, like this that dividend will be paid out of the profits of the company made in each year. If the intention is not clear, the presumption of accumulation will prevail. Thus, where by a subsequent amendment of the articles the word "cumulative" was dropped, even so the shares were taken to be cumulative because the description that remained in the articles carried no provision against accumulation. *Staples v. Eastman Pho.ographic Materials Co.,* (1896) 2 Ch 303; *Thornycroft & Co. Ltd. v. Thornycroft,* (1927) 44 TLR 9.

In the case of non-cumulative dividend, the funds out of which the dividend is to be payable may be further restricted, *e.g.*, that dividend shall be payable out of the profits of current year after making a provision for restoring the company's fixed assets to an efficient condition. *Dent v. London Tramways Co.,* (1880) 16 Ch D 344. See also, *Evling v. Israel & Oppenheimer Ltd.,* (1918) 1 Ch 101 where the provision for transferring sums to reserve account was second in priority to the preferential dividend for the year. EVE, J. held that the "profits" in this context consisted of the credit balance of the profit and loss account for each year before putting sums to reserve.

Arrears of cumulative preference dividend in winding up.—Here also, it is advisable to insert clauses in the articles to the effect whether in the event of winding up, the preference shareholders would be entitled to the arrears of dividends declared but not paid during the preceding years. *Roberts and Cooper Ltd., Re,* (1929) 2 Ch 383. If there is no clear term on the point, it would be a matter to be sorted out by construction of whatever terms are there affecting preferential rights. Where the provision was that preference shares would "rank both as regards dividends and capital in priority to the ordinary shares, but shall not confer the right to any further participation in profits or assets", it was held that this provision entitled the preference shareholders in the winding up to be paid the arrears in priority to any payment on the ordinary shares. *Walter Symons Ltd., Re.,* (1934) Ch 308 : (1934) 4 Com Cases 200, 206 (Ch D). See also, *de Jong (F.) & Co. Ltd., Re,* (1946) Ch 211 : (1946) 16 Com Cas 158 (CA); *E.W. Savory Ltd., Re,* (1951) 2 All ER 1036, where the provisions were similar. *Wood, Skinner & Co., Re,* (1945) 15 Com Cases 1 (Ch D); *MFR D'Cruz v. K.N. Viswanathan,* (1941) 11 Com Cases 277, 282 : AIR 1941 Mad 806. But where the provision was: "such preference shares shall confer the right to a fixed cumulative dividend of £ 6 per cent per annum on the capital paid-up thereon and shall rank both as regards dividend and capital in priority to the ordinary shares," it was held that this clause in reference to dividend was not wide enough to include arrears of the cumulative preference dividend in winding up. *Wood Skinner & Co. Ltd., Re,* (1944) Ch 323. Where there are no profits and no declaration of dividend, they would be entitled to nothing more than refund of capital. *MFR D'Cruz v. K.N. Vishwanathan, (Supra).* Arrears are computed up to the date of commencement of winding up and not up to the date of repayment. *E.W. Savory Ltd., Re, (Supra* at p. 1040).

Where arrears are payable in winding up, the sources of payment will be the assets left after paying liabilities and they will be paid in priority to any repayment of capital. *Ibid.* The word "assets" for this purpose is not confined to assets originating in profits. It means the mixed assets, whether originating in profits or otherwise. *Springbok Agricul-*

tural Estates Ltd., Re, (1920) 1 Ch 563; *Wharfedale Brewery Co. Ltd., Re,* (1952) 2 All ER 635. *Hall WJ & Co. Ltd., Re,* (1909) 1 Ch 521. Section 205(1) says "no dividend shall be declared or paid by a company for any financial year except out of the profits of the company for that year arrived at after providing for depreciation in accordance with the provisions of sub-section (2). The determination of profits for a particular year after providing for depreciation can only be the act of a company which is going concern. Section 217(1) refers to a report by the Board of Directors placed before a general meeting. But the Board of Directors becomes extinct and is replaced by the liquidator during the winding up proceedings. None of these sections can, therefore, apply during winding up. They do not, therefore, restrict or affect the right of the preference shareholders to payment of arrears of dividend during winding up." *Globe Motors Ltd. v. Globe United Engg. & Foundry Co. Ltd.,* (1975) 45 Com Cases 429, 439 (Del). Articles may contain a special specific provision on this point also so as to exclude the operation of this rule. *Ibid.* Accordingly, the ordinary shareholders can be called upon to pay the money due on their shares to enable the liquidator to pay off the capital amount to the preference shareholders and arrears of dividend. They cannot set off the amount called against the amount due to them by way of capital and dividends. *Bombay Chlorine Products Ltd., Re,* (1965) 35 Com Cases 282 at 294 (Bom).

In the case of non-cumulative preference shares, only the preceding year's arrears can be claimed, but that too if profits were made in that year. *Caulson v. Austin Motor Co.,* (1927) 43 TLR 493.

Where there is a surplus after paying the creditors, creditors should be paid interest on their claims before the preferential shareholders get anything. *Dehra Dun Mussoorie Electric Tram Company Limited, In re,* (1934) 4 Com Cases 66, 67 : AIR 1934 All 189. Where there is uncalled equity capital forming part of the asset of the company, the preference shareholders are entitled to be repaid out of the same. *MFR D'Cruz v. K.N. Viswanathan, (Supra).*

Participating dividend and capital rights.—Where, after paying the preference shareholders their fixed dividend and after paying whatever dividend is declared in favour of ordinary shareholders, there is still a surplus of profits which is proposed to be distributed among shareholders and where, in the winding up of the company after making a complete refund of all the shareholders there is still a surplus, which is proposed to be distributed, the question arises whether the preference shareholders have a right to participate in the distribution of such surpluses. If they have this right they are known as participating preference shares. The legal presumption is that they do not have this right and, therefore, all preference shares are presumed to be not participating. Participating rights can be given to them only by clear specific provisions on the point. *Isle of Thanet Electricity Supply Co. Ltd., Re,* (1949) 2 All ER 1060. The company's articles may give the preference shareholders in addition to their preferential dividend a share in the profits of the company. *In Re, Catalinas Warehouses and Mole Co. Ltd.,* (1947) 1 All ER 51 the company's articles provided that the preference shareholders were to receive a preferential dividend of 4 per cent, the ordinary shareholders a dividend of 4 per cent, and that the balance of the profits was to be applied in paying a dividend to both classes of shareholders treated as one class. Such shareholders cannot claim anything more than what is specifically provided about their participating rights. In the words of LORD HALDANE: ".... when you turn to the terms on which the shares are issued you expect to find all the rights as regards dividends specified in the terms of the issue. And when you do find these things prescribed, it certainly appears to be unnatural to go beyond them." *Will v. United Lankat Plantations Co. Ltd.,* (1914) AC 11 (HL); *Birch v. Cropper,* (1889) 14 App Cas 525 (HL).

Frustration of rights as to dividend.—For fiscal and economic reasons a company may choose to pay back its preference shareholders under a scheme of reduction of capital. They cannot complain of unfairness on the ground that they thereby are being de-

prived of their right of participation in the surplus profits which were expected in that year or in the years to come. *Saltdean Estate Co. Ltd., Re,* (1968) 3 All ER 829.

Preferential rights as to capital.—The right of participation in the surplus profits while the company is a going concern does not by itself entitle the preference shareholders to the right of participation in the surplus assets in winding up. There must be a specific provision conferring this right upon them. *Dimbula Valley (Ceylon) Tea Co. Ltd. v. Laurie,* (1961) 1 All ER 769; *Bridgewater Navigation Co., Re,* (1891) 2 Ch 317; *Scottish Ins. Corpn. Ltd. v. Wilson and Clyde Coal Co. Ltd.,* (1949) 1 All ER 1068. In the absence of such a right if they are paid out leaving all the surplus assets at the disposal of ordinary shareholders, they cannot complain of any unfairness or prejudicial conduct only on that ground. "In view of the precarious nature of the preference shareholders' rights, as stated in *Re, Saltdean Estate Co. Ltd.,* (1968) 3 All ER 829 and **affirmed** in *House of Fraser Plc. v. ACGE Investments Ltd.,* 1987 BCLC 478, it is probable that some further evidence of fraud or unfair conduct will be necessary in addition to the mere act of distribution." PALMER'S COMPANY LAW, 558 (24th Edn. 1987) : para 6.121, Vol. 1. 25th Edn., 1992. Their expectation that they will not be paid out and would go on enjoying the privilege of a fixed return on the investment may be frustrated, but they cannot complain because they should not reasonably expect anything more than what is specifically provided in their favour. In *William Jones & Sons Ltd., Re,* (1969) 1 WLR 146 it was further held that if a winding up was not in prospect, preference shareholders could be repaid at a lower value than that obtaining on winding up.

Rights of preference shareholders on winding up.—On a winding up, there is no presumption that the preference shareholders are entitled to share in the surplus assets. The onus is on them to prove that their rights were not exhaustively defined in the articles and that they were entitled to share in the surplus assets after the equity share capital has been paid. *Re, John Smith's Tadcaster Brewery Co. Ltd.,* (1952) 2 All ER 751 (Ch D). See also *Re, Duncan Gilmour and Co. Ltd.,* (1952) 2 All ER 871 (Ch D). Where the preference shareholders do not have the right to participate in the distribution in the winding up of the company, a resolution to pay them off and reduce the capital accordingly cannot be assailed on the ground of unfairness. *Prudential Assurance Co. Ltd. v. Chatterley-Whitefield Colleries Ltd.,* (1949) 1 All ER 1094 (HL).

Where all dividends due to the preference shareholders had been paid and there was a surplus representing accumulated profits, and the rights of preference shareholders were not expressly limited to return of capital and payment of preferential dividend, it was held that the surplus was distributable rateably between the preference and ordinary shareholders and that the surplus profit did not belong to the ordinary shareholders only. *Re, William Metcalfe & Sons Ltd.,* (1932) 148 TLR 82 : (1933) 3 Com Cases 315 (see also *Re, Foster & Son Ltd.,* (1942) 1 All ER 314).

§ See also Notes under S. 511 *post.*

Private company exempted.—The section does not apply to private company unless it is subsidiary of a public company. That means that such company may create and issue any other kinds of share capital and on any terms as it may think fit.

Secretarial Action Points for issue of share certificate

§ Refer to Notes under section 113.

[1][*S. 86. New issues of share capital to be only of two kinds.—The share capital of a company limited by shares shall be of two kinds only, namely:—*

(a) equity share capital—

(i) with voting rights; or

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1. Subs. by Companies (Amendment) Act, 2000 (53 of 2000), s. 38 (w.e.f. 13-12-2000).

(ii) with differential rights as to dividend, voting or other wise in accordance with such rules and subject to such conditions as may be prescribed[2]*;*

(b) preference share capital.]

NOTES

Companies (Amendment) Act, 2000

This section has been substantially changed. The share capital of a company will continue to be of two kinds namely, equity and preference. But equity capital has been subdivided into two categories, namely, shares with equal rights and shares with differential rights, as to dividend, voting or otherwise. Shares with differnetial rights would be capable of being created in accordance with the Rules prescribed by the Central Government.

One of the effects of this enlargement of share categories is that section 88 has become deleted because it prohibited issue of shares with disproportionate voting rights.

Differential Voting rights.—Shares with differential rights would have to be distinguished from shares with no voting rights. Section 87(1) confers voting rights upon every member of a company limited by shares and holding any equity share capital. Thus voting rights of all classes have to be maintained though they may be of differential nature. Where voting takes place by show of hands, each shareholder has only one vote. Thus differential voting rights can be made effective only through a poll.

Under the 1956 Act as amended by the Amendment Act, 2000, any company willing to adopt articles for floating shares with variable rights would have to take particular care of the fact that the fundamental corporate regime under section 87 and section 93 still is the equality of voting rights and dividend rights according to paid up portion of the share capital.

It may be recalled that the Companies Bill 1997 which has still not been enacted provided in the section dealing with voting rights that the voting right of a shareholder on a poll shall be *as stated in the articles.* The Amendment Act of 2000 has given power to companies to issue shares with variable voting rights but has retained the provision in section 87(1)(b) to the effect that voting right on a poll shall be in proportion to his share of the paid-up equity capital of the company.

The Companies (Issue of Share Capital with Differntial Voting Rights) Rules, 2001

The Department of Company Affairs has prescribed Companies (Issue of Share Capital with Differential Voting Rights) Rules, 2001 *vide* Notfn. SO 167(E), dt. 9-3-2001).

Press Release, dt. 21-3-2001.—The Government in the Department of Company Affairs (DCA) has promulgated the Companies (Issue of Share Capital with Differential Voting Rights) Rules, 2001. These rules have been notified in the Gazette of India and come into force with immediate effect.

Under the rules, every company limited by shares may issue shares with differential rights as to dividend, voting or otherwise, if the company has distributable profits in terms of section 205 of the Companies Act, 1956, for the three financial years preceding the year in which it was decided to issue such shares, the company has not defaulted in filing annual accounts and annual returns for the three financial years immediately preceding the financial year in which it was decided to issue such share, and the company did not fail to repay its deposits or interest thereon on the due date or redeem its debentures on the due date or pay dividend.

If the articles of association of the company authorise the issue of shares with differential voting rights, if the company has not been convicted of an offence arising under the Securities Exchange Board of India Act, 1992, the Securities Contracts (Regulation) Act, 1956, the Foreign Exchange Management Act, 1999, if the company has not defaulted in meeting investors' grievances, and obtained the approval of shareholders in general meeting by passing resolution as required under the provision of sub-clause (a) of

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2. The prescribed Rules are Companies (Issue of Share Capital with Differential Voting Rights) Rules, 2001 *vide* GSR SO 167(E), dt. 9-3-2001, see *Appendix* 39.

sub-section (1) of section 94 read with sub-section (2) of the said section of the Companies Act and the listed public company obtained approval of the shareholders through postal ballot.

The notice of the meeting at which resolution is proposed to be passed is accompanied by an explanatory statement stating five conditionalities.

Every company referred to in rule 3 shall maintain a register as required under section 150 of the Companies Act containing the particulars of differential rights to which the holder is entitled. [*PIB Press Release, New Delhi, dt. 21-3-2001*]

§ See also Notes under Sections 80 and 85.

§ For the text of "The Companies (Issue of Share Capital" with Differential Voting Rights) Rules, 2001, see *Appendix* 39.

Variable Rights Attached to Shares

The following passage in FRASER & STEWART, COMPANY LAW OF CANADA, pp 158-159; 165-166. [6th edn. 1993 by Harry Sutherland QC] shows some of the effects and aspects of variable rights attached to shares:

"Rights attaching to shares.—Where there is only one class of shares the rights of the holders are equal in all respects and include the rights to vote at any meeting of shareholders, to receive any dividend declared and on dissolution to receive the remaining property of the corporation. In *Muljo v. Sunwest Projects Ltd.* (1991), 2 B.L.R. (2d) 221 (B.C.C.A.) the Court held that, on a winding-up, every share without par value is equal to every other such share, subject to rights or restrictions which attach to those shares, and thus there is no two-stage process on winding-up which would permit repayment of capital to paid-up shareholders before a distribution of surplus capital.

"The articles may provide for more than one class of shares and if they so provide the rights, privileges, restrictions and conditions attaching to the shares are to be set out therein.

"Where the articles of incorporation provided that special common shares would carry ten votes per share in the hands of the initial holder but only one vote per share in the hands of any subsequent holder and an application was filed challenging the validity of the change in votes as well as the number of votes per share, the Ontario Court of Appeal held that the provision reducing the number of votes in the hands of a subsequent holder was invalid as there was a great opportunity for fraud but it was severable and as the provision for ten votes per shares had been in force for almost thirty years unquestioned by shareholders, the shares continued to carry ten votes per share: *Bowater Canadian Ltd. v. R.L. Crain Inc.*, (1987), 62 O.R. (2d) 752 (Ont. C.A.).

"Voting rights.—Section 24(3) of the Federal Act provides that where a corporation has only one class of shares the rights of the holders are equal in all respects and include the right, among others, to vote at any meeting of shareholders of the corporation; the articles may provide for more than one class of shares and, if so, the rights set out in s. 24(3) are to be attached to at least one class of shares but all such rights are not required to be attached to one class.

The former Act provided that no public corporation (i.e., a corporation which was not a private corporation) could have shares of any class or subdivision carrying an exclusive right to control the management of the business or affairs of the corporation; however, preferred shares could be created carrying the right to elect all or a majority of the board in a stated event, for example, when dividends were in arrears to a specified extent. As a result of the present provisions of the Federal Act it is now possible to have both multiple votes per share and a class of shares without any entitlement to vote of any kind. However, in the latter case, consideration must be given to the provisions of s. 176(5) which provides that in the case of a fundamental alteration a class vote may be required and in such a case the holders of such shares have a right to vote whether or not such shares otherwise carry the right to vote.

"The subject of cumulative voting [means that] each share having the number of votes for the election of directors as the number of directors to be elected".

Variations from one share-one vote rule

The American experience is shown by the following passage in AMERICAN JURISPRUDENCE (2d) § 1020 p. 863-864 (Vol. 18A): The rule that a holder of voting stock has one vote for each share of stock owned may be modified by a corporate charter, absent a contrary statutory or constitutional provision.[1] This view is taken by states that have enacted a statute similar to the Model Busienss Corporation Act section providing for modification of the one share-one vote rule by the articles of incorporation or bylaws[2]. Provisions in the articles or certificate of incorporation placing a maximum on the number of votes any one individual may cast, regardless of the number of shares owned, have been upheld as valid.[3] A bylaw providing that stockholders shall have one vote for each share held by them up to 10 shares, and fixing the proportion which their votes shall bear to their shares above that number, has been upheld as reasonable and uniform in its operation. *Detwiler v. Commonwealth,* 131 Pa 614, 18 A 990. The one share-one vote rule may be modified only in the manner provided by statute, however. *Groves v. Rosemound Improv. Asso.,* (La App 1st Cir) 413 So 2d 925, cert den (La) 420 So 2d 443. Under a statute allowing modification of the general rule in the certificate of incorporation, neither a corporation's bylaws nor a subscription agreement can be utilized to deprive record shareholders of the right to vote as provided by the statute. *Yu v. Linton (1st Dept),* 68 App Div. 2d 856, 414 NYS2d 558. Moreover, where aritcles of incorporation gave one shareholder only one vote at a meeting, but language on the back of stock certificates gave one vote to each share of stock, the positive langauge of the statute that, except as otherwise provided by law or by articles or bylaws, each share had one vote, was controlling, and under the article of the corporation a shareholder who desired one vote for each of his several hundred shares received only one vote. *Groves v. Rosemound Improv. Asso.,* (La App 1st Cir) 413 So 2d 925, cert den (La) 420 So 2d 443.

An injunction to restrain the voting of several shares of stock will lie where it appears that these shares were transferred without consideration to several persons and that powers of attorney were taken back by the real owners to enable them to cast a greater number of votes than the charter would allow to the single holder of the shares. *Campbell & Voss v. Poultney, Ellicott & Co.,* (Md) 6 Gill & J 94, [Where the charter gave a holder of one share two votes, and no more than 60 votes to any one shareholder.] Also, a limitation as to the number of votes which a single stockholder of a corporation is entitled to – cast in the direction of its affairs cannot be evaded by another corporation holding stock in the former by the gratuitous transfer of blocks of stock to its own directors individually for the purpose of having each vote the stock standing in his name in its interest". *Mack v. De Bardeleben Coal & I. Co.,* 90 Ala 396, 8 So 150.

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1. *Providence & Worcester Co. v. Baker* (Del Sup) 378 A2d 121, 3 ALR 4th 1198 (holding that corporate charter provisions limiting shareholders' voting rights do not violate a state corporate statute provision governing classes and series of stock and rights and are valid under corporate statutory provisions governing voting rights of stockholders and contents of the certificate of incorporation); *Deskins v. Lawrence County Fair & Development Corp.* (Ky) 321 SW2d 408 (wherein an article of incorporation providing that each share should have one vote, but that no person, organization, or association should have more than four votes was held valid under a statute authorizing the division of shares into classes which might have limited voting rights or nore at all).
2. *Groves v. Rosemound Improv. Asso.,* (La App. 1st Cir) 413 So 2d 925, cert den (La) 420 So 2d 443.
3. *Providence & Worcester Co. v. Baker* (Del Sup) 378 A2d 121, 3 ALR 4th 1198 (certificate of incorporation limiting percentage of total votes one stockholder could cast was valid); *Deskins v. Lawrence County Fair & Development Corp.* (Ky) 321 SW2d 408 (holding that a provision in the articles of incorporation of a county fair and development corporation that provided in part that each share of stock was entitled to one vote but that no person or organization, regardless of the number of shares owned, was entitled to more than four votes was valid, despite the contention of shareholders owning 60 percent of the outstanding common stock that the limitation was arbitrary, unreasonable, and against public policy).

Equity shares

Equity shares, in financial terminology sometimes referred to as the "risk" capital, normally confer on their holders the residue of rights of the company which have not been conferred on other classes. The equity shares usually carry the main financial risk if the company is unsuccessful, but they carry the greatest prospects of financial reward if the venture of the company is successful.

Preference shares

As their name implies, preference shares carry some preferential rights in relation to other class of shares, particularly in relation to equity shares. *Cf.* ROXBURGN J. in *Re, Powell Cotton's Resettlement,* (1957) Ch 159, 162.

It may be noted that while a company can have only equity share capital, but it cannot have only preference share capital. By the very definition of "preference share capital" in section 85, preference shareholders have certain preferential rights over the equity shareholders. Thus, in the absence of equity share capital, there cannot be preference share capital. *Cf. Bihar State Financial Corpn. v. CIT, Bihar,* (1976) 46 Com Cases 155 (Pat—DB).

Applicability of Provision to Private company.—The section does not apply to a private company unless it is subsidiary of a public company [Section 90]. That means that such a private company may issue share capital of such other kinds as it may think fit.

ICSI Guidance Note on Compliance Certificate (August, 2003)

The ICSI has issued a Check List for issue of Compliance Certificate under proviso to Sec. 383A(1) in respect of the matters specified under Rule 3 of the Companies (Compliance Certificate) Rules, 2001.

Paragraph 19 under Rule 3 relates to issue of capital and securities and reads as follows:

***Paragraph 19.*—The company has issued.....shares/debentures/other securities during the financial year and complied with the provisions of the Act.**

Issue of Shares with Differential Voting Rights [*Item (g)*]

Prescribed Check List

Check that :

(i) the Articles of Association authorise the issue of shares with differential voting rights;

(ii) the company has not been convicted of any offence arising under the SEBI Act, 1992; Securities Contracts (Regulation) Act, 1956 or the Foreign Exchange Management Act, 1999;

(iii) the company had distributable profits in terms of section 205 of the Act during the three financial years preceding the year in which aforesaid shares were issued;

(iv) the company has not defaulted in filing annual accounts and annual returns during the immediately preceding three financial years preceding the financial year in which the aforesaid shares were issued;

(v) the company has not failed to repay its deposits or interest thereon on due date or redeem its debentures on due date or pay dividend after it was declared;

(vi) the provisions in the Memorandum allow issue of the said shares. If not, whether the proposal for issue of the said shares has been approved by the shareholders under section 94 of the Act;

(vii) the company has not defaulted in meeting investors' grievances;

(viii) the proposal for issue of the said shares has been approved by the shareholders by special resolution by Postal ballot in the case of a listed company and by the

shareholders of any other company by special resolution under section 81 of the Act;

(ix) the sum total of the shares issued with differential voting rights is not more than 25% of the total capital of the company;

(x) the explanatory statement relating to the said resolution sets out the—

(a) the rate of voting right which the equity share capital with differential voting right shall carry;

(b) the scale or in proportion to which the voting rights of such class or type of shares will carry;

(c) the company shall not convert its equity capital with voting rights into equity share capital with differential voting rights and the shares with differential voting rights into equity share capital with voting rights;

(d) the shares with differential voting rights shall not exceed 25% of the total share capital issued;

(e) statement that a member of a company holding any equity share with differential voting rights shall be entitled to bonus shares, right shares of the same class;

(f) the holders of the equity shares with differential voting rights shall enjoy all other rights to which the holder is entitled to except right to vote as indicated in (a) above.

(xi) a register of members of shares with differential voting rights is being maintained.

S. 87. Voting rights.—(1) Subject to the provisions of section 89 and subsection (2) of section 92—

(a) every member of a company limited by shares and holding any equity share capital therein shall have a right to vote, in respect of such capital, on every resolution placed before the company; and

(b) his voting right on a poll shall be in proportion to his share of the paid-up equity capital of the company.

(2) (a) Subject as aforesaid and save as provided in clause (b) of this subsection, every member of a company limited by shares and holding any preference share capital therein shall, in respect of such capital, have a right to vote only on resolutions placed before the company which directly affect the rights attached to his preference shares.

Explanation.—Any resolution for winding up the company or for the repayment or reduction of its share capital shall be deemed directly to affect the rights attached to preference shares within the meaning of this clause.

(b) Subject as aforesaid, every member of a company limited by shares and holding any preference share capital therein shall, in respect of such capital, be entitled to vote on every resolution placed before the company at any meeting, if the dividend due on such capital or any part of such dividend has remained unpaid—

(i) in the case of cumulative preference shares, in respect of an aggregate period of not less than two years preceding the date of commencement of the meeting; and

(ii) in the case of non-cumulative preference shares, *either* in respect of a period of not less than two years ending with the expiry of the financial year immediately preceding the commencement of the meeting *or* in respect of an aggregate period of not less than three years comprised in the six years ending with the expiry of the financial year aforesaid.

Explanation.—For the purposes of this clause, dividend shall be deemed to be due on preference shares in respect of any period, whether a dividend has been declared by the company on such shares for such period or not,—

(a) on the last day specified for the payment of such dividend for such period, in the articles or other instrument executed by the company in that behalf; or

(b) in case no day is so specified, on the day immediately following such period.

(c) Where the holder of any preference share has a right to vote on any resolution in accordance with the provisions of this sub-section, his voting right on a poll, as the holder of such share, shall, subject to the provisions of section 89 and sub-section (2) of section 92, be in the same proportion as the capital paid up in respect of the preference share bears to the total paid-up equity capital of the company.

NOTES

Legislative History

§ See Legislative Changes under section 85.

Voting rights of equity shareholders

Voting rights are vested in persons whose names appear in the register of members *Performing Rights Society, Re,* (1978) 3 All ER 972 (CA) **reversing** (1978) 2 All ER 712. *Sharad Doshi v. Adjudicating Officer,* (1998) 3 Comp LJ 145 : (1998) 29 CLA 383. The matter was before SEBI in connection with the violation of SEBI Takeover Code.The right to vote is a proprietory right. *Jain (Smt.) v. Delhi Flour Mills Ltd.,* (1974) 44 Com Cases 228 (Delhi).

Sub-s. (1)(b) clearly declares that voting rights of a shareholder on a poll are to be in proportion to his share of the paid-up equity capital of the company. Accordingly, full voting rights cannot be conferred in respect of partly paid shares by any amendment of the company's articles. This would be repugnant to the aforesaid provision. *Ajit Singh v. DSS Enterprises P. Ltd.,* (2001) 45 CLA 102 : (2001) 34 SCL 547 : (2001) 4 Comp LJ 421 (CLB—PB).

A person whose name stands without qualification on the share register as a holder of shares has the right to vote at a meeting of the company. *Tough Oakes Gold Mines Ltd. v. Foster,* (1917) 39 QLR 144 (Can)

Unless otherwise provided by the Articles of a company, a shareholder is not debarred from voting by having a particular interest in the subject-matter of the vote. *MacDonald Bros v. Godson,* (1917) 1 WWR 233 : 23 BCR 166 (Can).

Directors and shareholders who were implicated in a breach of trust with respect to the company's property were not allowed to vote at a meeting called for the purpose of considering whether the company's name should be struck out from an action commenced by a shareholder in his own name and that of company's name *Leavens & Canada National Fire Insce Co. v. Gt. West Permanent Loan co. (No. 2)*, (1927) 3 WWR 486 (Can).

The manager of a company is neither entitled to attend a general meeting of the shareholders nor to vote in respect of forfeited shares registered in his name as manager in trust for the company *Melbourne Banking Corpn. Ltd., Cos Statute 1864*, (1885) 11 VLR 610 (Aus).

The section confers voting rights on every member holding any equity share capital, however small it may be. A company cannot by its articles or otherwise deny voting rights to holders of shares below a minimum number such as "only shareholders holding five or more shares are entitled to vote" and so on; nor can a maximum number of votes be fixed irrespective of the number of shares held by a member; the only exception being in the case of banking companies as noted below.

The voting rights mentioned here are further safeguarded by the provisions of Ss. 181 and 182. Section 181 provides that the articles of a company may provide that no member shall exercise any voting right in respect of the shares on which any calls or other sums presently payable by him have not been paid or in regard to which the company has a right of lien and has exercised that right.

Section 182 provides that a public company or a private company which is a subsidiary of a public company shall not prohibit any member from exercising his voting rights on the ground that he has not held his shares or other interest in the company for any specified period preceding the date on which the vote is taken or any other ground not being a ground set out in S. 181. For details see, notes under those sections.

The House of Lords held that that part of an agreement between shareholders to bind themselves, but not their successors, as to their voting behaviour on the creation of new shares was enforceable and was not tainted by the unenforceability of another agreement between the parties which sought to restrict the statutory power of the company to issue fresh capital. *Russell v. Northern Bank Developments Corpn. Ltd.*, 1992 BCLC 1016 : (1993) 3 Comp LJ 45 (HL).

Right to have vote recorded

A member has a right to have his vote recorded. In *Pender v. Lushington*, (1877) 6 Ch D 70, JESSEL MR highlighting the importance of member's voting rights observed as follows: "This is an action by Mr. Pender for himself. He is a member of the company, and whether he votes with the majority or the minority he is entitled to have his vote recorded—an individual right in respect of which he has a right to sue. That has nothing to do with the question like that raised in *Foss v. Harbottle* and that line of cases. He has a right to say, 'Whether I vote in the majority or minority, you shall record my vote, as that is a right of property belonging to my interest in this company, and if you refuse to record my vote I will institute legal proceedings against you to compel you'. What is the answer to such an action? It seems to me it can be maintained as a matter of substance, and that there is no technical difficulty in maintaining it ....."

At a meeting of the shareholders of a company, certain of the shareholders were, according to the decision of the majority of those present, not allowed to vote; these shareholders instituted a suit for a declaration that they were entitled to vote at the meeting. It was held that the plaintiffs had a cause of action and that there was nothing in the Companies Act to exclude the jurisdiction of the ordinary Civil Courts in such a suit. *Gobinda Prosad Das v. Akhoy Kumar Dey*, (1905-06) 10 CWN 906 (Cal—DB). The court **followed** the ruling in *Pender v. Lushington* (*Supra*).

Shareholders' voting agreements

It also deserves to be pointed out that a shareholder's vote is a property right and in general there is no duty to use it for the benefit of any body other than the shareholder. It is open to a member to become bound by contract to exercise voting power as directed by another person and that undertaking may be enforced by a mandatory injunction. *Puddephatt v. Leith,* (1916) 1 Ch 200; *Greenwell v. Porter,* (1902) 1 Ch 200. For American law on agreements by shareholders to pool their votes see, KRUGER (1978) 94 LQR 557.

§ For a detailed discussion on the subject see Note under s. 182 under the heading "Agreement as to voting".

Shareholders' pooling agreements

In its decision in *Rolta India Ltd. v. Venire Industries Ltd.,* (2000) 100 Com Cases 19 : (2000) 2 Bom CR 241 (DB) Y.K. SABHARWAL C.J., took an opportunity to observe as follows {at p. 248] : Regarding pooling agreement, it may be noted that it is an agreement between two or more shareholders which generally provides that in exercising any voting rights, the shares held by the shareholders shall be voted as provided therein; it is a contract to the effect that the shares held by them shall be voted as one single unit. The shareholders bind one another to vote as they mutually agree. In a pooling agreement, each shareholder retains sole ownership of shares binding himself only to vote for a specific person or in a certain way. These agreements are enforceable because the right to vote is a proprietary right. The right to vote may be aided and effectuated by a contract. Generally, pooling agreements are thought of in relation to control of private companies and smaller public companies. (See LAW QUARTERLY REVIEW, Vol. 84, p. 561).

A pooling agreement may be utilised in connection with the election of directors and shareholders' resolutions where shareholders have a right to vote. However, a pooling agreement cannot be used to supersede the statutory rights given to the board of directors to manage the company, the underlying reason being that the shareholders cannot achieve by pooling agreement that which is prohibited to them, if they are voting individually. Therefore, the power of shareholders to unite is not extended to contracts, whereby restrictions are placed on the powers of directors to mange the business of the corporation. It is for this reason that a pooling agreement cannot be between directors regarding their powers as directors. There is vast difference in principle between the case of a shareholder binding himself by such a contract and the director of the company undertaking such an obligation by compromising his fiduciary status. The shareholder is dealing with his own property. He is entitled to consider his own interests, without regard to interests of other shareholders. However, directors are fiduciaries of the company and the shareholders. It is their duty to do what they consider best in the interests of the company. They cannot abdicate their independent judgment by entering into pooling agrements. The company works through two main organs, *viz.* the shareholders and the board of directors.

In fact, in U.S.A. the law has made further advances. The American Courts have accepted that directors are fiduciaries of the various constituencies in the corporation. With globalisation, the concepts of merger and amalgamation have come into picture. With the companies issuing shares to employees and workers and also to set of creditors, the American Courts have accepted that in the company there are various constituencies like shareholders' constituency, workers' constituency, creditors' constituency *etc.* This advancement of law has been very vividly mentioned in Harvard International Law Journal, Volume 38, page 540 under the Chapter dealing with Constitutency Status. Implication for Director Fiduciary Duties. The Article mentions the advancement of Corporate Law. It is clear that directors shall not only act exclusively in the interests of shareholders or with reference to stock prices, but shall also be obliged to charter a course for the company which is in its best interest without regard to fixed investment horizon.

Applying the aforesaid principle, in particular the principle of fixed investment horizon, it would be noticed that the MOU (in this case) was entered into essentially to favour a fixed investment pattern. It was to protect the family interest in the event of division of the shareholding. It was never contemplated that the company would do well and would require infusion of capital. If this is the purpose, for which the MOU was entered into, and if this object is required to be kept in mind, then, it is clear that the MOU, which imposes a ban on the increase on the number of directors for all times, is likely to denude the powers of the board of directors and may cause sterilisation of directors, a terminology used in America. It is for this reason that the American Courts have taken the view that the pooling agreements, which are based on fixed investment objective, should not be made enforceable, if such agreements come in the way of directors' decision to charter a course which favours expansion of the company. It is also because the directors should not only look to the shareholders' interest or to maximise the shareholders' value in the context of a takeover, but it is their duty to make the corporation progressive. This approach is also very necessary because it encourages the growth of the company which is vital for the economic progress of the company. Moreover, the various authorities indicate that the pooling agreements are short-term measures, *viz.,* up to the next annual general meeting. They were never meant to operate in perpetuity. They are essentially meant to protect the proprietary interst of the shareholders. The courts have been slow in granting enforcement of such agreements. See *Hickman v. Kent Marsh Shipbreakers Association,* 1915 (1) Ch D 881.

The aforesaid decision also lays down that an agreement between shareholders cannot be construed to be a contract binding on the company even if the company has taken note of the pooling agreement or even if the company has acted thereon and, on this basis, the English Courts have denied specific performance of such agreements. The aforesaid judgment also lays down that even if the Articles provide that the directors shall give effect to the pooling agreement between the shareholders, still, such an agreement shall not be construed as part of the Articles and that acts performed pursuant to such an agreement cannot be ratified subsequently. It further lays down that, even if such an agreement is treated as being part of the Articles, still, it would not result in a binding contract *qua* the company.

"In the case of *Browne v. Trinidad,* 33 Ch Dn 1, the pooling agreement provided that the founder-member shall not be removed as a director for all times. He was subsequently sought to be removed. The court took the view that, even if the directors had acted upon the agreement in the past, such acts will not be binding on the company.

A reading of the above judgments indicate that the courts have been slow to enforce such pooling agreements. The pooling agreements, which are enforced are concerning only the right to vote of the shareholders. The courts have not been granting specific performance of the agreements whereby the powers of directors stand denuded.

The Supreme Court of Canada in *Ringuet v. Bergeron,* 1960 (24) DLR 449 (2-d), dealing with shareholders entering into agreement to vote unanimously and observing such agreements not to be illegal, at the same time held that the fiduciary relationship occupied by directors requires the exercise of these entire duties and attention to the best interest of the company and its shareholders. It was accordingly held that the discretion of the directors to act in the administration of the affairs of the company cannot be fettered by agreement and, therefore, such agreement was invalid.

In *Boulting v. Association of Cinematograph Television and Allied Technicians,* 1963 (2) QB 606, LORD DENNING M.R. while dealing with fiduciary nature of directors' duties and also referring to the opinion of LORD CRANWORTH L.C. in *Aberdeen Railway Co. v. Blaikie Brothers,* 1854 (1) Macq. 461, 471 HL (Scot) said : "It seems to me that no one, who has duties of a fiduciary nature to discharge, can be allowed to enter into an engagement by which he binds himself to disregard those duties or to act inconsistently with them. No stipulation is lawful by which he agrees to carry out his duties in accordance with the instrucitons of another rather than on his own conscientious judgment; or

by which he agrees to subordinate the interests of those whom he must protect to the interest of someone else."

"It is thus clear that the specific performance of pooling agreements between shareholder to vote in a particular manner cannot be extended to denude or sterlise the powers of directors and any such agreement would be unenforceable. (2000) 2 Bom CR 241 at 250 : (2000) 100 Com Cases 19 (Bom–DB).

A point form narrative of the varying aspects of the effect of shareholders' agreements has been given in learned work. It is as follows:

(1) A voting agreement is enforceable between the parties by injunction which may be either prohibitive (*Greenwell v. Porter,* (1902) 1 Ch 530) preventing the shareholder from voting in contravention of the agreement or mandatory (*Puddephatt v. Leith* (1916) 1 Ch 200) compelling him to vote in accordance with the wishes of the other party.

(2) The effect of the voting agreement on the company will depend upon the voting control which the shareholder concerned can exercise.

(3) As a company is only concerned with its registered shareholders, it will be bound to accept a vote made in contravention of a voting agreement; the remedy for the breach will lie between the parties to the agreement. However, the company could be joined in as a party to the agreement for the purpose of giving effect to its terms.

(4) A voting agreement (which is not ancillary to any transfer of an interest in shares) will not normally be caught by a pre-emption clause. Thus, if a company whishes to discourage transfers of control over its shares in this way it should adopt a disenfranchisement provision.

(5) It seems that a personal undertaking by a shareholder to vote in accordance with the wishes of another will cease to have effect on a transfer of the shares in question and that there is no implied term that the shareholder undertakes not to transfer his shares so as to ensure that the other party is not deprived of his rights under the voting agreement. *Greenhalgh v. Mallard and others* (1943) 2 All ER 234. Neither will the voting agreement be binding on transferees in such circumstances, even with notice. Thus, in order for a voting agreement to continue to be effective it should be accompanied by a restriction on the transfer of the shares.

(6) A director of a company who accepts the benefits of a voting agreement from a shareholder will be obliged to disclose it as a director's interest under s. 324 of the Act. [s. 299 Indian Act].

(7) In the case of a public company, such a benefit may constitute a 3 per cent or 10 per cent notifiable interest under ss. 198 to 220 of the Act. [Ss. 299-300 of Indian Act]

(8) Another effect may be to constitute one company a subsidiary or subsidiary; undertaking of another in accordance with the definitions contained in ss. 736 and 258 of the Act. [s. 4 of Indian Act].

(9) The effectiveness of a voting agreement depends upon the holder of voting rights being able to exercise his votes as he thinks fit. This is a general principle which the courts have been willing to uphold see *Northwest Transportation Co. Ltd. v. Beattie,* (1887) 10 App Cas 589, *Regal (Hastings) Ltd. v. Gulliver,* (1942) 1 All ER 378 and *Northern Counties Securities v. Jackson & Steeple,* (1974) 1 WLR 1133. However, in certain cases the court will interfere with the exercise of voting rights:

(a) where a shareholder holds shares of more than one class, he may not consider his interests as a holder of one class while exercising the voting

rights attaching to the shares of another class, *Re Holders Investment Trust Ltd.*, (1971) 1 WLR 583;

(b) the holders of a majority of the shares in a company must not use their voting power to oppress the minority see for example *Cook v. Deeks*, (1916) AC 554, *Brown v. British Abrasive Wheel*, (1919) 1 Ch 290 and *Clemens v. Clemens Brothers Ltd.*, (1976) 2 All ER 268;

(c) a resolution to alter the articles of association will be impeached if the effect of it is to discriminate between the majority shareholders and the minority shareholders so as to give the former an advantage to which the latter are deprived, *Greenhalgh v. Arderne Cinemas Ltd.*, (1951) Ch 286;

(d) the exercise of voting rights may amount to unfairly prejudicial conduct for the purposes of s. 459 of the Act [Section 397 of Indian Act] (see the comments of GIBSON J in *Re Ringtower Holdings plc* (1989) 5 BCC 82);

(e) in exceptional circumstances, the court will restrain a shareholder from voting in a particular way if it would be injurious to a creditor's interest. Such exceptional interests will exist, for example, where the shareholder has some ulterior motive for putting pressure on the creditor or because he is simply not rational in his conduct see *Standard Chartered Bank v. Walker, TSB Bank plc v. Walker* (1992) BCLC 603 where, in respect of a company which was in actute financial difficulties, the court restrained certain shareholders from voting otherwise than in favour of a restructuring prposal supported by its bankers where it was concluded that obstructing the reconstruction was so pointlessly harmful that it would amount to wilful dissipation of assets and the security which the banks held over other shares in the company would be destroyed needlessly by the company collapsing. GRAHM STEDMAN & JANET JONES : SHAREHOLDERS' AGREEMENTS, 109, 110 [3rd Edn. 1998].

No automatic termination of disproportionate voting rights

Disproportionate voting rights did not stand automatically terminated by the coming into force of this Act. The regulation of voting rights provided under this section can take effect only after complying with S. 89(1). Till that is done, existing voting rights are not affected except to the extent provided in S. 89(2). *Mahant Vaishnava Dass v. Fakir Chand*, AIR 1968 Del 6.

But even so the combined effect of sections 87, 88 (*since omitted*) and 89 is to bring about a complete equality of voting rights not only between holders of equity shares but also *vis-a-vis* preference shareholders. For a view of this combined operation of the sections see, *Juvansinghji Balu Sinhji v. Balbhadhra Sinhji, etc.*, (1962) 32 Com Cases 1162 (Guj).

Joint holders' right to split holdings

Unless a company had adopted an article on the lines of Regulation 7(3) of Table A of Schedule I, joint shareholders will be entitled to have their holding of shares split into such number of smaller holdings as there are number of joint holders and have the names of all of them registered in such order as will entitle all of them to receive notice of general meetings of the company and exercise voting right.

Voting rights of preference shareholders [Sub-section (2)]

(1) Preference shares may be cumulative or non-cumulative as explained in sub-section (2)(b).

(2) The holders of preference shares of both classes have a right to vote on any resolutions of the company directly affecting their rights.

(3) Where dividends are in arrear,—

(a) holders of cumulative preference shares have a right to vote on all resolutions of the company at any meeting if their dividends are in arrear for an aggregate period of not less than two years on the date of the meeting;

(b) holders of non-cumulative preference shares have a right to vote on all resolutions of the company at any meeting, if their dividends are in arrear for the two financial years immediately preceding the meeting or for any three years, during a period of six years ending with the financial year preceding the meeting;

(c) the voting right of each holder of a preference share of either class will be in the proportion which the capital paid-up on his shares bears to the total equity share capital of the company.

A provision in a company's articles that the preference share dividend 'shall be deemed to be payable' was taken to mean that the dividend was deemed payable whether or not there were profits out of which it could be paid. Consequently, as the dividend on the preference shares was in arrears the preference shareholders were held to be entitled to vote on all matters affecting the company. *Bradford Investments Ltd., Re,* 1991 BCLC 224 (Ch D).

Resolutions affecting rights attached to preference shares

Where the directors proposed to increase the share capital of the company by issue of further equity shares, by capitalising an amount standing to the credit of the company's reserve account, and applying the same in paying up the new equity shares, and distributing the same as fully paid among the equity shareholders the proposed resolution was held to affect the rights of the preference shareholders and could, therefore, be only carried out with their sanction. The words 'affect' has a wide import. *Re, John Smith's Tadcaster Brewery Co. Ltd.,* (1952) 2 All ER 751 and (1953) 1 All ER 518.

Rights of preference shareholders are held not "affected" by the issue of additional ordinary shares, though their voting rights are thereby weakened. See *White v. Bristol Aeroplane Co. Ltd.,* (1953) 1 All ER 40 (CA).

Where the value of preference shares is reduced by paying out the shareholder, his voting rights and right to dividend would be proportionately reduced and this would in essence be a transfer of property rights making him liable to pay tax on capital gain, if any *Kartikeya V. Sarabhai v. CIT,* (1997) 26 Corpt LA 328 (SC).

Voting rights in case of Banking Companies

Section 12 of the Banking Regulations Act as amended by the Banking Regulation (Amendment) Act, 1994, provides:

"(2) No person holding shares in a banking company shall, in respect of any shares held by him, exercise voting rights on poll in excess of ten per cent of the total voting rights of all the shareholders of the banking company".

And section 2 of that Act says that the provisions of that Act shall be in addition to and not, save as otherwise expressly provided in that Act, in derogation of the Indian Companies Act. See also Sec. 616(b) of the Companies Act, 1956.

A regulation adopted under State Bank of India Act providing that a member of the bank shall have only one vote in respect of each block of 50 shares during the 3 months prior to the date of the meeting was held to be not valid. Any such restriction could have been envisaged under the provisions of the Act only, and not under regulations. *Tamal Kumar Majumdar v. Union of India,* (2000) 38 CLA 44 (Cal).

RBI Guidelines as to voting rights in banks.—In terms of the statutory provisions under the various banking acts, the voting rights, when exercised, have been stipulated which are indicated as under:

1. Private Sector Banks – [Section 12(2) of Banking Regulation Act,1949]	No person holding shares, in respect of any share held by him, shall exercise voting rights *on poll* in excess of ten percent of the total voting rights of all the shareholders.
2. Nationalised Banks – [Section 3(2E) of Banking Companies (Acquisition and Transfer of Undertakings) Acts, 1970/80]	No shareholder, other than the Central Government, shall be entitled to exercise voting rights in respect of any shares held by him in excess of one percent of the total voting rights of all the shareholders of the nationalised bank.
3. State Bank of India (SBI) - (Section 11 of State Bank of India Act,1955)	No shareholder, other than RBI, shall be entitled to exercise voting rights in excess of ten percent of the issued capital, (Government, in consultation with RBI can raise the above voting right to more than ten percent).
4. SBI Associates - [Section 19(1) and (2) of SBI (Subsidiary Bank) Act, 1959]	No person shall be registered as a shareholder in respect of any shares held by him in excess of two hundred shares. No shareholder, other than SBI, shall be entitled to exercise voting rights in excess of one percent of the issued capital of the subsidiary bank concerned.

[*RBI Circular No. DBOD No. BP.BC. 68/21.01.055/2001-2002, dt. 16-2-2002*]

Pledge or attachment of shares, effect upon voting rights

Voting rights of a member are not affected by the fact that his shares have been attached or pledged or a receiver has been appointed. This is so even if the member is a company whose management is taken over by the Central Government under the Industries (Development & Regulation) Act, 1951. Nor can the member be prevented from issuing notice requisitioning a meeting under S. 169 or from exercising voting rights at the requisitioned meeting merely because a receiver has been appointed of those shares. *Balkrishan Gupta v. Swadeshi Polytex Ltd.*, (1985) 58 Com Cases 563 : AIR 1985 SC 520.

In *Life Insurance Corporation of India v. Escorts Ltd.*, (1986) 59 Com Cases 548 at 637 : AIR 1986 SC 1370 the Supreme Court has held that the 'State' or an instrumentality of the State as a shareholder is in the same position as any other shareholder with all the rights available to such shareholder. The Court held that there is no reason why the State as shareholder should be expected to give the reasons when it seeks to change the management by moving a resolution.

Share transfer under defective procedure and voting rights

In a Scottish case, *Dempsey v. Celtic Football and Athletic Co. Ltd.*, 1992 Green's Weekly Digest, 25—1406, Lord PROSSER held that, where shares in a private company had been transferred without the correct procedures as laid down in the articles of association having been complied with, the transfers (which had been registered by the company) were still effective to pass beneficial ownership in the shares. Accordingly the transferees were entitled to exercise the votes attached to the shares in question. The error had been one of form rather than of substance. An interim interdict to stop the exercise of the votes was therefore refused.

Injunction against use of voting rights

In a novel case VINELOTT J. held that the court has inherent jurisdiction, similar to that exemplified by the *Mareva* injunction remedy, to restrain a shareholder from doing

something to the assets of the company so as to constitute a detriment to the interests of creditors. Such jurisdiction was, however, only to be exercised in extreme cases. In this particular case leading shareholders in a company that was in financial difficulties were ordered not to oppose a scheme of reconstruction which had as a key element their removal as directors, because, if the rescue of the company failed, their shares would become worthless and damage would be done to creditors—*Standard Chartered Bank v. Walker,* (1992) BCLC 603 (Ch D). Majority shareholders were restrained in an Australian case from exercising their voting power for removing existing management and to replace it with a set of directors who to all intent and purpose wanted to use the assets of the company for the benefit of the majority shareholders only. *Thescus Exploration NL v. Mining and Associated Industries Ltd.,* (1973) Qd R 81 (Aust).

Manner of exercising voting rights

Three modes are available for this purpose:

(1) by show of hands [*see Notes under s. 177*]

(2) by Poll [*see Notes under s. 179*]

(3) by Postal Ballots [*see Notes under s. 192-A*]

Private company exempted

Disproportionate voting rights.—The section does not apply to a private company unless it is subsidiary of a public company [section 90]. That means that such a private company may issue shares with such voting rights as it may think best in its own interest.

[1][S. 88. Prohibition of issue of shares with disproportionate rights.—* * * * *]

NOTES

Companies Amendment Act, 2000

This section has been omitted by the Amendment Act, 2000 consequent upon the modification made in section 86 permitting issue of equity shares with differential voting rights. However the Notes have been retained in the interest of knowledge in case of need.

§ See Legislative Changes under section 85.

The section contains an absolute prohibition as regards the issue of shares with disproportionate voting rights and rights as to dividend, capital or otherwise, after the commencement of this Act.

Abeyance of dividend rights till shares become fully paid-up

Department's Clarification I.—The Department of Company Affairs is of the view that the abeyance of the rights as to the dividends on the new equity shares till they are fully paid up does not amount to issue of shares with disproportionate rights as to dividends which is prohibited under s. 88. It is to be noted that on these shares (subsequently issued) becoming fully paid up, they will rank *pari passu* with the existing shares in the matter of payment of dividend. (*Letter No.* F. 2/36/63-PR).

Department's Clarification II.—The Department of Company Affairs has further clarified that there would not be a case of issue of shares with disproportionate rights if a Company having already issued fully paid-up shares of a class issues partly paid-up shares of that class with the latter shares not being entitled to dividends. [*Company News & Notes,* July, 1968 Issue] However, there would be a clear case of issue of shares with disproportionate rights if dividends are paid on some

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1. S. 88 omitted by the Companies (Amendment) Act, 2000 (53 of 2000), s. 39 (w.e.f. 13-12-2000), priors to its omissions it stood as under:

S. 88. Prohibition of issue of shares with disproportionate rights.—No company formed after the commencement of this Act, or issuing any share capital after such commencement, shall issue any shares (not being preference shares) which carry voting rights or rights in the company as to dividend, capital or otherwise which are disproportionate to the rights attaching to the holders of other shares (not being preference shares).

partly paid-up shares to the exclusion of others. For example, if the articles of the company provide that dividends may be paid if the shares are paid-up to the extent of 75% or more it may lead to a contravention of Sec. 88.

Clarification regarding import of Sections 88 and 93

Department's view.—Section 88 prohibits issue of shares (not being preference shares) which carry voting right or rights as to dividends, capital or otherwise which are disproportionate to the rights attaching to the holders of other shares (not being preference shares). What is the significance of the word "Otherwise" used in the section? In view of the provisions of this section read with section 93, can a company which had already issued equity shares of a certain nominal value which are fully paid, issue further equity shares of the same face value but call up only a part of the amount with a condition that until such shares are fully called up and paid, no dividend will be payable on such shares? This Department's views on the points raised are as follows:—

(i) The word 'otherwise' may include *inter alia* rights as to participating in surplus in the event of winding up, mode of repayment, *etc.*;

(ii) There is no conflict between the provisions of sections 88 and 93. It is permissible to issue further equity capital in the manner suggested, subject to an enabling provision in the articles of association of the company. (*Company News & Notes*, dated 1st July, 1963.)

Private company exempted.—The section does not apply to a private company unless it is subsidiary of a public company [section 90]. This means that such a private company is not prohibited from issuing shares with disproportionate voting rights.

S. 89. Termination of disproportionately excessive voting rights in existing companies.—(1) If at the commencement of this Act any shares, by whatever name called, of any existing company limited by shares carry voting rights in excess of the voting rights attaching under sub-section (1) of section 87 to equity shares in respect of which the same amount of capital has been paid-up, the company shall, within a period of one year from the commencement of this Act, reduce the voting rights in respect of the shares first-mentioned so as to bring them into conformity with the voting rights attached to such equity shares under sub-section (1) of section 87.

(2) Before the voting rights are brought into such conformity, the holders of the shares in question shall not exercise in respect thereof voting rights in excess of what would have been exercisable by them if the capital paid-up on their shares had been equity share capital, in respect of the following resolutions placed before the company, namely:—

[1][*(a) any resolution relating to the appointment or re-appointment of a director or to any variation in the terms of an agreement between the company and a managing or whole time director thereof;*]

(b) any resolution relating to the appointment of buying or selling agents;

(c) [2][* * * *]

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1. Clause (a) substituted by the Companies (Amendment) Act, 2000 (53 of 2000), s. 40 (w.e.f. 13-12-2000). Prior to its substitution, it stood as under:—
"(a) any resolution relating to the appointment or re-appointment of a director or a managing agent or secretaries and treasurers, to any variation in the terms of an agreement between the company and a managing or whole-time director thereof or its managing agent or secretaries and treasurers;"

2. Clause (c) omitted by the Companies (Amendment) Act, 2000 (53 of 2000), s. 40 (w.e.f. 13-12-2000). Prior to its omission it stood as under :
"(c) any resolution relating to the grant of a loan or to the giving of a guarantee or any other financial assistance, to any other body corporate having any person as managing agent or secretaries and treasurers who is also either the managing agnet or the secretaries and treasurers who is also either the managing agent or the secretaries and treasurers of the company or an associate of such managing agent or secretaries and treasurers."

(3) If, by reason of the failure of the requisite proportion of any class of members to agree, it is not found possible to comply with the provisions of sub-section (1), the company shall, within one month of the expiry of the period of one year mentioned in that sub-section, apply to the Court for an order specifying the manner in which the provisions of that sub-section shall be complied with; and any order made by the Court in this behalf shall bind the company and all its shareholders.

If default is made in complying with this sub-section, the company, and every officer of the company who is in default, shall be punishable with fine which may extend to [3][*ten thousand rupees*].

(4) The Central Government may, in respect of any shares issued by a company before the 1st day of December, 1949, exempt the company from the requirements of sub-sections (1), (2) and (3), wholly or in part, if in the opinion of the Central Government the exemption is required either in the public interest or in the interests of the company or of any class of shareholders therein or of the creditors or any class of creditors thereof.

Every order or exemption made by the Central Government under this sub-section shall be laid before both Houses of Parliament, as soon as may be, after it is made.

NOTES

§ See Legislative Changes under section 85.

Companies (Amendment) Act, 2000

1. The terms "managing agents, secretaries and treasurers" have been omitted by the Amendment Act, 2000. The amendment is of consequential nature.

2. *Penalty enhanced.*—The Amendment Act of 2000 enhanced the penalty amount from 1,000 rupees to 10,000 rupees under sub-section (3).

3. *Effect of amendments.*—The Companies Act, 1956 had abolished the variety of shares which companies were permitted to issue under the 1913 Act. It permitted the issue of only three types of security, namely—shares, ordinary and preference and debentures. This scheme of the Act seems to have run out of the emerging corporate scenerio the world over. The Working Group found this world trend and recommended that a greater number of securities should be permitted and not necessarily with uniform features and rights. In keeping with this recommendation, section 88 of the 1956 Act, which prohibited the disproportionate voting rights has been deleted. Section 89 of the 1956 Act carried a transitional provision to enable companies to abolish disproportionate rights. Now that shares with differential rights have been sanctioned, it appears that section 89 which has already outlived its transitional period should have been deleted. But this has not been done. The section has been retained with slight amendments, namely the reference to the managing agents or secretaries or treasurers in sub-section (2A) has been deleted. The section may not serve any purpose in view of the changed regime as to securities that companies may now issue.

Scope of section

The section requires that voting rights shall, in respect of all equity shares bear the same proportion as the amount of share capital paid-up, that is to say, voting rights should in all cases be in the same proportion as the amount of share capital paid-up. For an explanation

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3. The words "one thousand rupees" substituted by the Companies (Amendment) Act, 2000 (53 of 2000), s. 40 (w.e.f. 13-12-2000).

of the way in which the present Act has brought about equality of voting rights see, *Juwansinhji Balu Sinhji v. Balbhadra Sinhji, etc.*, (1962) 32 Com Cases 1162 (Guj).

While excessive voting rights on share capital issued before the commencement of this Act are terminated by the end of a period of one year after such commencement, other disproportionate rights as to dividend, *etc.*, attached to existing shares, are not sought to be affected (see section 90). So in the case of existing companies all existing differential rights other than excessive voting rights are allowed to continue as before.

Power of exemption [Sub-section (4)]

An order of exemption under sub-section (4) if unconditionally made, cannot be subsequently revoked by the Central Government. See *Nava Samaj Ltd. v. Registrar of Companies,* AIR 1966 Bom 218 (DB). But as pointed by the Supreme Court in *Barium Chemicals,* case, AIR 1967 SC 295 though an order passed in exercise of power under a statute cannot be challenged on the ground of propriety or sufficiency, it is liable to be quashed, if the Court is satisfied that in passing that order the Government did not apply its mind to the relevant facts. The rule is applicable not only to *quasi*-judicial orders but also administrative orders. *Mahant Vaishnava Das v. Fakir Chand,* AIR 1968 Del 6 (DB). See also the Notes under section 637-A.

Note that District Courts are empowered to exercise the jurisdiction and powers conferred on the court by this section (see Notes under s. 10).

Private company exempted.—The section does not apply to a private company unless it is subsidiary of a public company [section 90].

Effect of not complying with provision

One effect of non-compliance is that the penalty provision would be attracted. But it did not mean that after paying penalty, one could go on enjoying disproportionate voting rights. After the expiry of the waiting period, a shareholder could enjoy only equal voting rights within the meaning of s. 87(1)(*b*) irrespective of the fact whether disproportionate voting rights have been formally terminated by the company or not. *Namita Gupta v. Cachar Native Joint Stock Co. Ltd.*, (1999) 98 Com Cases 655 : (1999) 34 CLA 287 : (2000) Comp LJ 511 (CLB—PB). In view of the reintroduction of shares with differential rights, the decision is only of historical value.

Penalty for default [Sub-section (3)]

If by reason of the failure of the requisite proportion of any class of members to agree, it is not found possible to comply with the provisions of section 89(1), the company is required to apply to the court for an order specifying the manner in which compliance with the provisions has to be made and the order of the court made in this behalf is binding on the company and of its shareholders. If the default is made in complying with the provision of sub-section (3), the company and every officer of the company who is in default are punishable with fine up to Rs. 10,000/-.

Compoundable offence.—The offence is compoundable under section 621A.

[1][**S. 90. Savings.**—(1) Nothing in sections 85, 86, 88 and 89 shall, in the case of any shares issued by a public company before the commencement of this Act, affect any voting rights attached to the shares save as otherwise provided in section 89, or any rights attached to the shares as to dividend, capital or otherwise.

(2) Nothing in sections 85 to 89 shall apply to a private company, unless it is a subsidiary of a public company.

(3) For the removal of doubts, it is hereby declared that on and from the commencement of the Companies (Amendment) Act, 1974, the provisions of section

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1. This section was substituted for old section by the Amendment Act 41 of 1974 (w.e.f. 1-2-1975).

87 shall apply in relation to the voting rights attached to preference shares issued by a public company before the 1st day of April, 1956, as they apply to the preference shares issued by a public company after that date.

Explanation.—For the purposes of this section, references to a public company shall be construed as including references to a private company which is a subsidiary of a public company.]

NOTES

Companies Amendment Act, 1974

Recommendation of Joint Committee.—The present section has been substituted for the old section by the Amendment Act, 1974, on the recommendation of the Joint Committee on the Bill, which said : "The distinction made by the existing Act between the preference shares issued by a public company before and after the commencement of the Companies Act, 1956, should be removed and all the preference shares should be placed on the same footing, so that no extra voting right is enjoyed by the preference shares which are issued before the 1st day of April, 1956. Accordingly, section 90 of the principal Act has been substituted by a new section". (*Report* : Para 23.)

Though sub-section (1) is not expressed in clear language, sub-section (3), makes the position clear.

The effect of the exemption of private companies from the provisions of sections 85 to 89 is that as regards the issue of shares with disproportionate voting rights, they are free from the restrictions imposed by these sections. A private company, if it is subsidiary of a public company, is not exempted, nor if it is a private banking company (*vide* section 49 of the Banking Regulations Act, 1949).

Right of company which ceases to be private company to maintain disparities in voting rights, dividend rights and participation rights on liquidation [Sub-section (2)]

Section 85 provides that the share capital of a company shall be restricted to preference share capital and equity share capital. It is, therefore, not permissible for a public company to have capital of a class which is neither preference nor equity share capital. By virtue of section 86, a public company is prohibited, after the commencement of the Act, from issuing classes of shares other than equity or preference shares. There is, however, no such prohibition in respect of a private company. By section 88, disproportionate voting rights were also sought to be abolished. Section 89 provided that after the commencement of the Act no shares, by whatever name called, of any existing company limited by shares should carry voting rights in excess of the voting rights attaching under section 87 and that those that did carry disproportionate voting rights should be brought into conformity with the provisions of section 87(1) within one year of coming into force of the Act. It was not found necessary to make any provision in regard to a private company issuing shares with disproportionate voting rights even after the enactment of the Companies Act 1956. Thus, a private company which was not a subsidiary of a public company could issue share capital other than equity share capital and preference share capital. It could also issue capital with disproportionate rights in regard to dividend and participation in any surplus on liquidation and with disproportionate voting rights. If such a company, by a resolution under section 44, converted itself into a public company the saving in terms of section 90(2) would cease to apply to it, but there is no provision in the Companies Act analogous to section 89 which makes it obligatory for a public limited company to modify disproportionate rights in regard to dividend, participation in capital and voting rights attached to shares issued by it when it was a private company. There is thus apparently a lacuna in the Act. The Act contains no provision for reducing the dis-

parity between the shareholders in regard to those rights after voluntary conversion into a public company.

Miscellaneous Provisions as to Share Capital

S. 91. Calls on shares of same class to be made on uniform basis.—Where after the commencement of this Act, any calls for further share capital are made on shares, such calls shall be made on a uniform basis on all shares falling under the same class.

Explanation.—For the purposes of this section, shares of the same nominal value on which different amount have been paid-up shall not be deemed to fall under the same class.

NOTES

Companies Act, 1956

This section is based on the recommendation of the Company Law Committee that "where calls are made, they must be made on a uniform basis for the amounts so called on each share in any particular class". (*Report* : page 244.) A company has no longer any power to differentiate between the shareholders as regards the amount and time of payment of calls.

The *Explanation* was added by the Joint Committee to "make it clear that shares though of the same nominal value will belong to different classes if the amount paid-up on the shares are different". (*Joint Committee Report* : para 64).

Power to be exercised in company's interest

The amount called up has to be used for the benefit of the company and it should also be called only in the interest of the company. The directors' decision in this respect being a decision of business nature, if it is arrived at in the good faith, it will not be open to judicial review. *Odessa Tramway Co. v. Mendel,* (1878) 8 Ch D 235 (CA). *Bailey v. Birkenhead, Lancashire and Cheshire Junction Rly. Co.,* (1850) 12 Beav 433; *Anglo-Universal Bank v. Baragnon,* (1881) 45 LT 362 (CA). A company sold its undertaking to another company in return for shares. Some of its own shares were still not paid-up. It called the amount in order to pay the unpaid portion on the shares in the transferee company. The call was held to be valid. *New Zealand Gold Extraction Co. v. Peacock,* (1894) 1 QB 622 (CA). But where the company was in difficult circumstances and the directors issued a call only to enable them to draw their own remuneration, the call was held to be an abuse of power and the directors were bound to refund the remuneration drawn by them. *Alexander v. Automatic Telephone Co.,* (1900) 2 Ch 56 (CA). See also *Galloway v. Halls Concerts Society,* (1915) 2 Ch 233, a call made on dissentient members only; *Re, European Central Rly. Co., Sykes,* case (1872) LR 13 Eq 255, directors drawing their fee out of call money while company insolvent. The directors are not trustees for the company's creditors. *Poole Jackson & Whytes* case, (1878) 9 Ch D 322, 328 (CA).

Requisites of valid call

A call must be dated. An undated call is ineffective unless a date is put on it by a subsequent resolution. *Re, Cawley & Co.,* (1889) 42 Ch D 209 (Ch). Minor irregularities may not affect the validity. A call was issued with the authority of the board, but one of the directors participating in the meeting was disqualified having parted with his qualification shares, nevertheless the call was held to be valid. *Dawson v. African Consolidated Land and Trading Co.,* (1898) 1 Ch 6 (CA).

Shareholders' informal agreement for capital call.—In *Euro Brokers Holdings Ltd. v. Monecor,* (2003) 1 BCLC 506 (CA), the Court of Appeal held that by their conduct both the shareholders had agreed to treat the notice of 31 October 2000 as a capital call under the shareholders' agreement and to proceed as if that capital call had been made by

the board of the company and therefore, applying the principle that if all the members of a company agreed on certain matters that was as effective as a decision by the company's board, the agreement of the shareholders to meet a call for capital without the need for a notice issued by the board was as binding on them as if the call had been made pursuant to anotice issued by the board. The principle permitting members of the company to reach agreement without the need for strict compliance with formal procedures was not restricted to internal corporate governance or to whether an act could be described as an act of the company. What mattered was whether there was unanimous agreement of all the members of the company to waive or vary the prescribed procedures. If there was, a member could not be heard to say that he was not bound by the agreement because the formal procedures had not been followed regardless of whether the formal procedures in question were stipulated in the articles of association, the Companies Acts or a separate contract between the members of the company.

Liability of members in respect of shares

A member is liable to pay the full nominal value of his shares and the amount unpaid on his shares is a debt due from him to the company. S. 36(2). *Shiromani Sugar Mills Ltd. v. Debi Prasad,* (1950) 20 Com Cases 296 (All); *J.C. Chandia v. Pearey Lal,* ILR (1942) All 26; *Link Industries Ltd., Re,* (1957) 27 Com Cases 468 (Mad). Accordingly, where shares are not fully paid for at the time of issue, the balance up to the nominal value may be called up wholly or in part in accordance with the articles or by the liquidator in winding up. All that this section requires is that calls on shares of the same class shall be made on a *uniform basis.* All shares falling under the same class have to be called on a uniform basis to pay the amount unpaid. An explanation to the section says that for the purposes of the section, shares of the same nominal value on which different amounts have been paid-up shall not be deemed to fall under the same class. This will prevent a call being made on some of the members only and the articles cannot give a power of this kind now. *Galloway v. Halls Concerts Society,* (1915) 2 Ch 233.

Remedies of shareholders, if call invalid

If a call is invalid, either because it does not comply with the Companies Act, or it is not in conformity with the company's articles, the shareholder is not bound to pay and he can get an injunction restraining the directors from forfeiting his shares. The court may require the member that he should pay the money into the court. *Lamb v. Sambas Rubber and Gutta Percha Co. Ltd.,* (1908) 1 Ch 845. He cannot restrain directors from taking proceedings for recovering the call amount because he has all the rights to defend himself by exposing the invalidity of the call. If a shareholder wants to resist a call on the ground of mis-representation in the prospectus, he must apply at once by a counter claim or a separate action for rectification of the register of members. *First National Re-insurance Co. v. Greenfield,* (1921) 2 KB 260. See also, *Galloway v. Halls Concerts Society, (Supra).*

Notice of call

Calls are made by serving upon members a notice of payment in accordance with the provisions of Sec. 53. It should be a formal notice and not a mere demand or a request for payment. Thus where a company acquired the rights of another company in respect of its uncalled capital and demanded payment from the members, it was held that such a demand could not take the place of a formal call notice. *Pabna Dhana Bhandar Co. Ltd. v. Foezuddin Mia,* AIR 1932 Cal 716. The call notice must have the backing of a resolution of the Board as per section 292(1)(a) and must be in compliance with company's articles. The notice must specify the exact amount and the time of payment. *E & W Insurance Co. Ltd. v. Kamala Mehta,* AIR 1956 Bom 537; *Major Teja Singh v. Hindustan Petroleum Co. Ltd.,* (1961) 31 Com Cases 573 (Punj); *Pioneer Alkali Works Ltd. v. Amiruddin Shalebhoy Tyebji,* AIR 1926 Bom 341; *Dhanraj Kesarimal v. H.H. Wadia,* (1933) ILR 57 Bom 413. In *Bengal Electric Lamp Works Ltd., Re,* (1942) 12 Com Cases 238 (Cal). Notice was held defective when it failed to mention the person to whom the payment was to be made. *Premila Devi v. Peoples Bank of Northern India,* (1939) 9 Com Cases 1 (PC);

Mahalakshmi Textiles Mills Ltd. v. A.K.R.M.M.K. Aeyyappa Chettiar, (1949) 19 Com Cases 246 (Mad).

If the contents of the notice are certain in terms of money demanded and time allowed for payment the notice will be valid even if its form is inaccurate. *Shackleford, Ford & Co. v. Dangerfield,* (1868) LR 3 CP 407; *Chubwa Tea Co. of Assam Ltd. v. Barry,* (1866) 15 LT 449.

The fact that no notice has been sent to other shareholders is immaterial. *Newry and Enniskillen Rly. Co. v. Edmunds,* (1848) 2 Exch 118.

In *Euro Brokers Holdings Ltd. v. Monecor,* (2003) 1 BCLC 506 (CA), informal agreement shareholders' dispensing with a call was held to be binding. (See under the heading "Shareholders' infomral agreement for capital call" (*supra*).

Calls on joint holders and their liability

Whether or not an Article similar to Regulation 15 of Table A of Schedule I has been adopted by a company making joint holders jointly and severally liable to pay calls in view of the specific provisions of section 43 of the Contract Act, the English decisions based on the general rule of English Law, [*Maxwell's* case, *Hill's* case, (1875) 20 Eq 585 and other subsequent cases] holding that in the absence of any provision in the Articles as to several liability, there would be only joint liability among the joint holders, is not applicable to joint holders of shares in Indian Companies. Under Indian Law joint holders are jointly and severally liable.

Calls on directors' shares

Alongwith other shareholders, the directors have also to be called on uniform basis to pay the amount due on their shares and like all other shareholders they can also transfer shares before a call is made to escape liability. *Cawley & Co.,* (1889) 42 Ch D 209 (CA). Where the articles of the company so authorise, the directors may pay the amount uncalled on their shares and apply it in payment of a debt of the company in the ordinary course of business even if the effect is to relieve them of their liability as guarantors of the debt so paid off. *Poole, Jackson and Whyte's* case, (1878) 9 Ch D 322 (CA). By virtue of the provision of S. 274(1)(e) if a director has not paid any call in respect of the shares held by him in the company for a period of six months from due date, he will be disqualified from being appointed as a director of the company.

Payment of calls and set-off

Calls have to be paid in cash, because otherwise, the shareholder would remain liable in winding up. Where, however, something is due from a company to a member, the same may be set-off against the call amount, *Larocque v. Beauchemin,* 1897 AC 358 though no such set-off is allowed during the winding up of the company. [S. 469]. If a set-off is allowed during a period of six months preceding to a petition for winding up it would be a fraudulent preference. *Re, Washington Diamond Mining Co.,* (1893) 3 Ch 95 (CA). A director who, before winding up, gives a promissory note to secure a debt of the company cannot, after winding up, set-off the amount against a call made before the winding up: *Re, Norwich Equitable Fire Insurance Co., Brasnett's* case, (1884) 32 WR 1010; **affirmed** (1885) 53 LT 569.

A set-off can be allowed against a debt presently due and owing by the company to the shareholder and not against one which will be payable at some future date. *Habershon's* case, (1868) LR 5 Eq 286; *Holden's* case, (1869) LR 8 Eq 444; *Adamson's* case, (1874) LR 18 Eq 670; and see, *Re, Norwich Equitable Fire Insurance Co. Brasnets's* case, (1884) 32 WR 1010 : (1885) 53 LT 569 (CA). *Cf. Sykes'* case, (1872) LR 13 Eq 255; *Laxman Singh v. Industrial East Co. Ltd.,* (1914) 25 IC 673.

An agreement to set-off a present debt of the company against a future call is also good. *Jones, Lloyd & Co. Ltd.,* (1889) 41 Ch D 159. An outstanding call may be settled by accord and satisfaction by assuring that the consideration is real and not illusory.

White Star Line, Re, (1938) 1 All ER 607 : (1939) 9 Com Cases 85. A call can be effectually paid in money's worth otherwise than by cash and such a payment is effectual where the consideration given is regarded by the parties as fairly representing the dues purporting to be discharged. Quoted from BUCKLEY, COMPANIES ACT, 13th Edition, page 802. *Hind Iran Bank Ltd. v. Raizada Jagannath Bali,* (1959) 29 Com Cases 418 (Punj). However, no company can give a commitment to a shareholder to enable him to pay his future calls in goods or in money's worth. *Black & Co.'s* case, (1872) 8 Ch App 254; *Pellatt's* case, (1867) 2 Ch App 527; *Elkington's* case, (1867) 2 Ch App 511; *Re, London and Colonial Co., ex p., Clark,* (1869) LR 7 Eq 550; and see, *Gardner v. Iredale,* (1912) 1 Ch 700.

Interest on call money and period of limitation

The articles of a company may provide that if a call is not paid within time, interest will be charged at a certain rate. Clause 16 of Table A hints at 5% interest giving the liberty to the Board to waive payment of such interest wholly or in part. In the absence of any provision for interest in the articles of association, after notice to pay on a fixed day has been given, interest may be claimed from the date fixed till the date of payment. *Re, Overend, Gurney & Co., ex p., Lintott,* (1867) LR 4 EQ 184; *Barrow's* case, (1868) 3 Ch App 784; *Stocken's* case, (1868) 3 Ch App 412. For non-payment of calls, after forfeiture, interest in arrear may be recovered. *Faure Electric Accumulator Co. Ltd. v. Phillipart,* (1888) 58 LT 525; *Collector of Moradabad v. Equity Insurance Co. Ltd.,* (1948) 18 Com Cases 309 (Oudh) where the court did not allow 12% interest.

The call amount being a statutory debt the period of limitation is twelve years from the date that the payment is due. [The Limitation Act, 1963]

Forfeiture of shares [Arts 29 to 35 Table 'A']

§ See Notes under s. 108 under the same heading.

Effect of transfer and forfeiture

Where shares have been transferred and the property in the shares has passed to the transferee, the transferee becomes liable to pay the call money and will have to indemnify the transferor if the money is recovered from him on the basis of his name being present in the register of members. Where, however, a call was made before the transfer and was payable after the transfer, apparently the transferor remained liable. *National Bank of Wales, Taylor, Philips and Rickward's* cases, (1897) 1 Ch 298, 306 (CA). Where the shares have been forfeited or transferred and the transferor's name is removed from the register, the transferor would remain liable as a past member in the winding up of the company for a period of one year under the conditions laid down in section 426 *infra*. For detailed discussion as to forfeiture of shares see, Notes under S. 108, *infra*.

Effect of Insolvency of member

On the insolvency of a member unpaid calls are provable in the insolvency. *Row, Ex p., West Coast Gold Field Ltd.,* (1904) 2 KB 489; *McMahon, Fuller v. McMahon,* (1900) 1 Ch 173. If the dividend received from the insolvent's estate is less than the amount due, the insolvent's estate will not rank as a fully paid shareholder. *Row, Ex p., West Coast Gold Field Ltd.,* (1905) 1 Ch 597 **affirmed** in (1906) 1 Ch 1 (CA). See also, *Cresswell Ranchi & Cattle Co. Ltd. v. Balfour,* (1902) 9 SLT 356. Where a member's shares were forfeited and re-issued and he became insolvent, the company can recover from the estate of the insolvent member only the difference between the amount due and the re-allotment value with interest due on the call. *Bolton, Ex p., North British Artificial Silk Ltd.,* (1930) 2 Ch 48.

Effect of death of member

The estate of a deceased member remains liable for payment of calls whether made before or after his death. The recovery can be effected either from the estate or if the estate has been distributed among his successors from them personally out of such distribution.

Houldsworth v. Evans, (1868) LR 3 HL 263 at 283; *Baird's* case, (1870) 5 Ch App 725; *New Zealand Gold Extraction Co. (Newbery-Vautin Process) v. Peacock,* (1894) I QB 622 (CA); *Taylor v. Taylor,* (1870) LR 10 Eq 477.

Where the legal personal representatives get the shares transferred to their names or request for it, they will become personally liable even if their names are not yet entered in the register of members. *Buchan's* case, (1879) 4 App Cas 549 (HL). Where the shareholder dies without leaving behind any legal heir the court may appoint a nominee of the company as an executor of the deceased member's estate. *Tomlinson v. Gilly.* (1885) 54 LJ P 80.

Advance payment of calls

Section 92 provides that a company may, if so authorised by its articles, accept from any member the whole or a part of the amount remaining unpaid on his shares although no part of that amount has been called up. Such an advance payment will not augment the voting power of the member until it becomes presently payable. For purposes of sanctioning a scheme of arrangement, shareholders with uncalled money paid in advance on their shares were held to be a separate class from fully-paid shareholders: *Re, United Provident Assurance Co., Ltd.,* (1910) 2 Ch 477.

The directors must exercise this power only if it is for the benefit of the company. Thus where the company had no money to pay directors' sitting fees and they paid into the company's bank account the amount due on their shares and that very day withdrew the amount to pay to themselves their sitting fees, it was held that the payment was not for the benefit of the company and the directors still remained liable to pay the amount due on their shares. *European Central Rail Co., Sykes* case, (1872) LR 13 Eq 255. This result did not follow in a case in which directors paid the money due on their shares in advance and then used it for paying off the company's legitimate debt, though they were the guarantors of that debt. *Pool Jackson & Whytes* case, (1878) 9 Ch D 322 (CA). The shareholder who has paid-up the money in advance of calls becomes a creditor of the company for the amount of interest which may accrue on the amount of advance payment. Such interest can be paid out of capital also if there are no profits. *Lock v. Queensland Investment and Land Mortgage Co., (Supra).* But he is not a creditor for the amount paid by him in advance because he cannot demand repayment and the company cannot pay him back unless the articles so provide. *Lock v. Queensland Investment and Land Mortgage Co., (Supra), Scottish Queensland Mortgage Co. Ltd., Petitioners,* (1908) 46 SLR 22 (where the court sanctioned a reduction of capital which included a ratification of repayment by the company to the shareholders of calls paid in advance); and *London and Northern S S Co. Ltd. v. Farmer,* (1914) 111 LT 204. Capital cannot be paid up in advance by setting off an existing debt. *Kent's* case, (1888) 39 Ch D 259 (CA); *Cf. Ferrao's* case, (1874) 9 Ch App 355; and see *Re, Liverpool and London Guarantee and Accident Insurance Co.,* (1882) 30 WR 378.

SEBI Guidelines, 2000 regarding call money

Securities Issued to be made Fully Paid Up

(a) If the subscription money is proposed to be received in calls, the calls shall be structured in such a manner that the entire subscription money is called within 12 months from the date of allotment.

(b) If the investor fails to pay call money within 12 months the subscription money already paid may be forfeited.

(c) If the issue size is above Rs.500 crores and is subject to monitoring requirement as per Clause 8.17.1 below, it shall not be necessary to call the entire subscription money within 12 months [*Clause 8.6.2 of Chapter VIII*].

Requirement of Monitoring Agency

In case of issues exceeding Rs.500 crores, the issuer shall make arrangements for the use of proceeds of the issue to be monitored by one of the financial institutions [*Clause 8.17.1*].

A copy of the monitoring report as per the format specified at Schedule-XIX to SEBI Guidelines, 2000, shall be filed with SEBI by the said monitoring agency, on a half yearly basis, till the completion of project, for the purposes of record [*Clause 8.17.2*].

§ For text of the SEBI Guidelines, 2000 for Disclosure and Investors Protection, refer *Appendix* 162.

ICSI Guidance Note on Compliance Certificate (August, 2003)

The ICSI has issued a Check List for issue of Compliance Certificate under proviso to Sec. 383A(1) in respect of the matters specified under Rule 3 of the Companies (Compliance Certificate) Rules, 2001.

Paragraph 19 under Rule 3 relates to issue of capital and securities and reads as follows:

***Paragraph-19.*—The company has issued..... shares/deben-tures/other securities during the financial year and complied with the provisions of the Act.**

Prescribed Check List

Calls on Shares/Debentures [*Item (h)*]

Check whether:

(i) call on shares/debentures was made by the Board of directors by means of resolutions passed at the Board Meeting as required under section 292(1)(a);

(ii) call on shares/debentures complied with the stipulations contained in the Articles of Association;

(iii) the Board of directors approved the rate of interest payable on delayed payment of calls in conformity with the provisions contained in the Articles of Association.

Forfeiture and Re-issue of Shares [*Item (i)*]

(a) *Forfeiture*

Check whether :

(i) the company has forfeited shares during the year in accordance with provisions contained in the Articles;

(ii) necessary noting/recording has been done in the Register of members and other registers.

(b) *Re-issue of Forfeited Shares*

Check whether:

(i) the company has reissued the forfeited shares and if so, the re-issue has been done in accordance with the provisions contained in the Articles;

(ii) the aggregate of the amount received on forfeited shares and amount received on the reissue of those forfeited shares was not below the issue price of the original shares which were duly forfeited;

(iii) share certificates have been issued to the allottee(s) and necessary entries made in the Register of members.

Note : There is no need to file return of allotment with ROC for reissue of forfeited shares.

§ For the text of the Companies (Compliance Certificate) Rules, 2001, see *Appendix* 38.

§ For the full text of the Guidance Notes on Compliance Certificate and for Specimen Compliance Certificate Form as issued by ICSI see *Appendix* 312.

S. 92. Power of company to accept unpaid share capital, although not called up.—(1) A company may, if so authorised by its articles, accept from any member the whole or a part of the amount remaining unpaid on any shares held by him, although no part of that amount has been called up.

(2) The member shall not, however, be entitled, where the company is one limited by shares, to any voting rights in respect of the moneys so paid by him until the same would, but for such payment, become presently payable.

NOTES

Eng. Act, 1948 : Sec. 59(b). Previous Act : Sec. 49(2).
Eng. Act, 1985 : Sec. 119.

Companies Act, 1956

Power to accept payment of uncalled capital.—The provision in clause (1) under the previous Act which authorised a company "to make arrangements on the issue of shares for a difference between the shareholders in the amounts and time of payment of calls on their shares" has been omitted as it was considered that this power was open to abuse. "It does not also seem to be necessary that when shares are issued at the same time, different provision should be made in regard to the amounts or the time of payment of calls on the shares". (*Notes on clause* 85 of the Companies Amendment Bill, 1957).

It has to be noted that the power to accept unpaid capital not called up can be exercised only where authorised by the articles. See also, Table A Article 18.

Voting rights not affected [Sub-section (2)]

Sub-section (2) was added by the Joint Committee "to make it clear that the payment of any amount voluntarily made towards the uncalled share capital, will not give voting rights in respect of that amount". (*Report :* para 45).

This section provides that a company may, if so authorised by its articles, accept from any member the whole or a part of the amount remaining unpaid on his shares although no part of that amount has been called up. Such an advance payment will not augment the voting power of the member until it becomes presently payable. For purposes of sanctioning a scheme of arrangement, shareholders with uncalled money paid in advance on their shares were held to be a separate class from fully-paid shareholders: *Re, United Provident Assurance Co., Ltd.,* (1910) 2 Ch 477.

Advance payment of calls

The rate of interest permitted by the articles on such advance payment is 6%. But it can be varied by the shareholders in general meeting. *Deputy CIT v. Manipal Industries Ltd.,* (1997) 12 SCL 15 (ITAT—Bangalore). (10% interest as resolved by the shareholders was considered to be quite reasonable).

§ See Notes under S. 91 under the heading "advance payment of calls".

Secretarial Practice Notes : power to accept uncalled share capital

(a) Check whether amount remaining unpaid on any shares and not called up had been accepted by the company? If so, whether such an act was authorised by the articles and supported by a Board Resolution?

(b) Check that the member who had paid the uncalled amount had not exercised voting rights in respect thereof.

Documents Involved: 1. Articles, 2. Register of calls, 3. Register of Members, 4. Minutes of Board Meeting.

S. 93. Payment of dividend in proportion to amount paid-up.—A company may, if so authorised by its articles, pay dividends in proportion to the amount paid up on each share where a larger amount is paid-up on some shares than on others.

NOTES

Eng. Act, 1948 : Sec. 59(c).
Eng. Act, 1985 : Sec. 119.

Previous Act : Sec. 49(3).

Companies Act, 1956

This section was inserted by the Joint Committee on the Companies (Amendment) Bill, 1953. Such a provision also existed in section 49(3) of the 1913 Act.

Scope of section

In the absence of a provision in the articles of association authorising payment of dividend in proportion to the amount paid-up on each share, dividend will have to be paid only in proportion to the nominal value of shares. *Oakbank Oil Co. v. Crum,* (1882) 8 App Cases 65 (HL); *Wilkinson v. Cummins,* (1853) 11 Hare 337; *Birch v. Cropper Re, Bridgewater Navigation Co. Ltd.,* (1889) 14 App Cases 525 (HL); *Wake Field Rolling Stock Co., Re,* (1892) 3 Ch 165, 172.

The amount of calls paid in advance does not form part of the paid-up capital.

§ See also Notes under Art. 88 of Table A.

Department's Clarifications.—For Clarifications see Notes under S. 88.

Secretarial Practice Notes : Payment of dividend in proportion to amount paid-up

Check whether the company had paid dividends in proportion to the amount paid-up on each share where a larger amount was paid-up on some shares than on others? If so, whether such payment was authorised by the Articles?

Documents Involved: 1. Dividend Payment Register, 2. Articles.

S. 94. Power of limited company to alter its share capital.—(1) A limited company having a share capital, may, if so authorised by its articles, alter the conditions of its memorandum as follows, that is to say, it may—

(a) increase its share capital by such amount as it thinks expedient by issuing new shares;

(b) consolidate and divide all or any of its share capital into shares of larger amount than its existing shares;

(c) convert all or any of its fully paid-up shares into stock, and reconvert that stock into fully paid-up shares of any denomination;

(d) sub-divide its shares, or any of them, into shares of smaller amount than is fixed by the memorandum, so however, that in the sub-division the proportion between the amount paid and the amount, if any, unpaid on each reduced share shall be the same as it was in the case of the share from which the reduced share is derived;

(e) cancel shares which, at the date of the passing of the resolution in that behalf, have not been taken or agreed to be taken by any person, and diminish the amount of its share capital by the amount of the shares so cancelled.

(2) The powers conferred by this section shall be exercised by the company in general meeting and shall not require to be confirmed by the Court.

(3) A cancellation of shares in pursuance of this section shall not be deemed to be a reduction of share capital within the meaning of this Act.

NOTES

Eng. Act, 1948 : Sec. 61. Previous Act : Sec. 50.
Eng. Act, 1985 : Sec. 121.

Alteration of share capital

Note that the powers under this section can be exercised only if authorised by the articles. It has been held that if the articles do not contain any such authorisation, the articles must first be amended, before the power can be exercised. *Re, Patent Invert Sugar Co.,* (1885) 31 Ch D 166. But there is no reason why in a single meeting both a special resolution amending the articles and a resolution for exercise of any of the powers under this section should not be passed. *Cf. Re, North Cheshire Brewery Co.,* 1920 WN 149. *Re, Bank of Hindustan, China and Japan, Campbell's* case, *Hippisley's* case, *Alison's* case, (1873) 9 Ch App I at 21; *Taylor v. Pilsen, Joel and Electric Light Co.,* (1884) 27 Ch D 268. However in *Re, Metropolitan Cemetery Co.,* (1934) SC 65 (Scot) the company passed special resolutions to reduce and also to increase its capital and the court, while confirming the former, refused to include a reference to the latter as the company was not authorised by its articles to increase its capital and strict compliance with the Act was necessary.

The power should be exercised *bona fide* in the interest of the company and not for benefiting any group. *Piercy v. Mills(s) & Co.,* (1920) 1 Ch 77; *Needle Industries (India) Ltd. v. Needle Industries Newey (India) Holding Ltd.,* (1981) 1 Com Cases 743 (SC); *Jai Hanuman Trading Co. (P.) Ltd., Re.,* (1962) 32 Com Cases 201, 205 (P & H). That is why an agreement between shareholders requiring a written consent of all the shareholders before this power was exercised was held to be void. But a shareholders' agreement as to how to vote on occasions like this may bind them as between themselves and without fettering the company's powers. *Russell v. Northern Bank Devp. Corpn. Ltd.,* 1992 BCLC 1016 : (1993) 3 Comp LJ 45 HL **affirming** *sub-nom Russell v. Northern Bank Devp. Corpn. Ltd.,* 1992 BCLC 431 (CA) (Northern Ireland).

§ See also Notes under S. 81.

Increase of share capital [Sub-section (1)(a)]

The consent of meetings of classes of shareholders will not be requisite as the increase of any kind of share capital cannot be said to 'vary' or 'affect' class rights. See *White v. Bristol Aeroplane Co. Ltd.,* (1953) 1 All ER 40 (CA); *Re, John Smith's Tadcaster Brewery Co. Ltd.,* (1953) 1 All ER 518 (CA).

Subject to any directions that may be given by the company in general meeting the increased share capital will have to be issued in accordance with the provisions of section 81. In the case of a public company it appears that the provisions of sec. 81 are mandatory and the general body cannot give any contrary directions.

The section authorises companies to meet their capital requirements by increasing share capital by such amount as may be expedient. This power has to be exercised in general meeting. The increased capital may be expressed in the same currency as the ex-

isting capital but it may as well be expressed in any other currency. *Scandinavian Bank Group plc.*, (1987) 2 All ER 70.

According to the provisions in Arts. 44 and 45 of Table A the power of increase, *etc.*, given by this section can be implemented by an ordinary resolution. In case where Table A is not applicable it would appear that a special resolution may become necessary because the capital clause of the memorandum would have to be altered.

The increased capital may consist of preference shares, provided that this is not inconsistent with rights given by the memorandum of association. *Andrews v. Gas Meter Co.*, (1897) I Ch 361 (CA). The notice convening the meeting to pass the resolution for increase must specify the amount of the proposed increase. *MacConnell v. E Prill & Co. Ltd.*, (1916) 2 Ch 57.

Where shares were issued beyond the authorised amount and a resolution was subsequently passed at a general meeting ratifying the issue, it was held that although the original issue was not in accordance with the articles, the ratification was effective and the allottees bound. *Sewell's* case, (1868) 3 Ch App 131; *Bhimbhai v. Ishwardas, Jugjiwandas*, (1893) ILR 18 Bom 1524. See also, *In Re, London & New York Investment Co.*, (1895) 2 Ch 860.

Shareholders who have acquiesced in the irregular increase of the share capital cannot later challenge such an increase. *Re, Athenaeum Life Assurance Society; Richmond's* case, *Painters'* case, (1858) 4 K & J 305.

Fetters on exercise of power to increase capital

A restructuring agreement was entered into for the restructuring of the company. The parties to the agreement were the company, its bankers and its senior executives who held the entire issued share capital of the company. A clause in the restructuring agreement provided that no further share capital should be created or issued without the written consent of all the parties to the agreement. The company proposed to increase its capital and one of the parties to the restructuring agreement sought an injunction to prevent the company from doing so on the ground that it violated the important clause of the agreement. It was held that the clause of the agreement sought to be invoked constituted an unlawful fetter on the statutory power of the company to increase its share capital by ordinary resolution and as such it was void and unenforceable. The company was not prevented from exercising its statutory powers. *Russell v. Northern Bank Development Corpn. Ltd.*, 1992 BCLC 431 (CA) (NI). The House of Lords in [*Russell v. Northern Bank Development Corpn.*, 1992 BCLC 1016 **affirmed** this aspect of the matter but held that a voting agreement outside the articles may be binding. Their Lordships said that although any provision in a company's articles which restricts its statutory power to alter its articles would be invalid, an agreement outside the articles between shareholders as to how they would exercise their voting rights on a resolution to alter the articles is not necessarily invalid. Accordingly, so far as the original shareholders were concerned, their agreement did not constitute an unlawful and invalid fetter on the company's statutory power to increase its share capital but was merely a personal agreement outside the articles between the shareholders who executed it as to how they would exercise their voting rights in relation to the creation or issue of shares in the company and did not purport to bind future shareholders. The company's agreement that it would not increase its capital without the consent of each of the shareholders was unenforceable as being contrary to the Northern Ireland's company law because it amounted to an undertaking not to exercise its statutory power for a period which could last for as along as any of the parties to the agreement remained a shareholder although the control of the company had passed to other shareholders.

Injunction to prevent certain shareholders from voting.—In another interconnected matter reported as *Standard Chartered Bank v. Walker; TSB Bank plc. v. Walker*, 1992 BCLC 603 (Ch D), the company was in acute financial difficulties. A meeting of the company's shareholders was summoned to approve a restructuring agree-

ment between the company and the substantial number of banks to which it was indebted. Two non-executive directors were also sought to be removed. One of those directors and his associate company had 5% and 10% of the votes that could be cast at the meeting. There was evidence to suggest that if the structuring plan was not approved, the company would collapse. Two of the banks sought an order that the director and his associate company should vote in favour of the scheme or alternatively they should be enjoined from voting against the scheme. The court said that it would only be in most extreme cases that the court would grant an injunction to prevent a shareholder from voting his shares. But where the conduct of the shareholder is manifestly injurious to the interests of the company, the court can intervene. The court granted the injunction because it was in the interests of the company as well as its creditors.

Effect of provisions in articles on power to increase capital *vis-a-vis* statutory provisions.—In a case before the Bombay High Court, *Miheer Hemant Mafatlal v. Mafatlal Industries Ltd.*, (1987) 89 Bom LR 86 (Bom) the articles of a company happened to contain two contradictory provisions one of them permitting increase of capital by an ordinary resolution in the terms of S. 94 and another placing a limit beyond which the capital of the company would not be increased. The court held that such textually inconsistent provisions must be read subject to cross references reconciling them. Further, the article which restricted the power to increase the capital of the company beyond a certain amount would be void in itself because it has the effect of taking away the power conferred by S. 94 upon every company to increase its capital by an ordinary resolution and it was also inconsistent with clause 5 of this particular company's memorandum of association. It was no doubt true that this clause of the articles could have been altered only by a special resolution but the clause being void and therefore inoperative, the capital could be increased by an ordinary resolution in spite of this clause. It was not necessary for the company first to pass a special resolution, delete that particular provision and then exercise the power of increasing capital. The propositions of law which emerge from the judgment can be summarised as follows:

(1) It is well-settled position in law that the increase of share capital referred to in S. 94 is the increase of authorised share capital and not increase of the issued share capital.

(2) Where an article in the articles of association of a limited company is substantially in *pari materia*, with sub-s. (1) of S. 94 of the Companies Act, 1956, and it provides that the company may in general meeting increase its share capital by issue of new shares, the similarity in language clearly leads to conclusion that what is referred to in the article is share capital as referred to in S. 94(1), namely, the authorised share capital or the nominal share capital of the company and not the issued share capital. Such an article in the articles of association of a limited company does confer a power on the company to amend capital clause in its memorandum of association.

(3) When an article in the articles of association of a limited company, dealing with powers to increase share capital does not specify that the increase in the share capital is to be effected by any particular type of resolution, namely, whether this should be done by an ordinary resolution or by a special resolution, it must follow that the power to increase share capital can be exercised by an ordinary resolution.

(4) Where there is no particular type of resolution referred to in the articles of association as being required in order to enable the company to do any particular act, an ordinary resolution to that effect will suffice. Merely because another article in the articles of association of the company limiting share capital of the company to a specified limit cannot be amended except by a special resolution, it cannot lead to the conclusion that the provisions of that article must be read in such a manner as to limit the power of the company to increase the share capital only by passsing a special resolution.

(5) It is true that the articles of a company can be altered only by passing of a special resolution in view of the provisions of S. 31 of the Companies Act, 1956. If two provisions in the articles of association are textually inconsistent they must be read subject to cross references reconciling them.

European community directive and local economic legislation

Under the Greek economic legislation, the Greek authorities were empowered to take over control of a company and the authorities could authorise the increase in the capital of the company. The authorities took over control of a company and authorised an increase in its capital. Shareholders in the company commenced proceedings alleging that

the increase violated art. 25 of the Second Company Law Directive. The National Court stayed the proceedings and referred the matter to the Court of Justice to determine. It was held that the provisions of the Directive were unconditional and sufficiently precise to be relied on and invoked by an individual against the State. The Directive must be interpreted so as to preclude national rules which, in order to ensure the survival and continued operation of undertakings which were of particular economic and social importance for society as a whole, provided for the increase of a company's capital by administrative act rather than a vote of the shareholders even where the pre-emptive rights of the shareholders were preserved. *Karella v. Minister of Industry, Energy and Technology,* (1994) 1 BCLC 774 (CJEC).

The fact that the complaining shareholder may have gained economic benefits from the rescue of the company does not debar a legal action by him alleging breach of Artcicle 29 in increasing capital without shareholders' approval. *Alexandros Kefalas v. Elliniko Dimosio* (Case C-367/96) **unreported** but noted in E.C.J. Bulletin 13/98. [PALMER IN COMPANY, 1998-September]

In case C-441/93 *Panagis Pafitis v. Bank of Central Greece,* [EC S, 12-3-1996] an increase in the capital of a bank made by the Greek Government without approval of the general meeting was held to be contrary to Arts. 25 to 29 of the Second Directive. The court rejected the argument that banks were not subject to the Directive.

In *Siemens AG v. Nold,* (1997) 1 BCLC 291, the ECJ considered the compatibility of Art. 29(1) and (4) with German case law imposing compliance with certain conditions in order to enable the withdrawal of a shareholder's pre-emption right in the context of an increase in capital for consideration in kind. It was held that the national provisions were valid, and that Member States were free to make rules concerning rights of pre-emption in relation to increase in capital for consideration other than a cash consideration.

Consolidation of shares [Sub-section (1)(b)]

Consolidation is the process of combining a specified number of shares into one new share, the new share has to be of a nominal value equal to the aggregate of the shares so consolidated. This power has also to be exercised in the general meeting in the manner authorised by the articles. Table A prescribes only an ordinary resolution. But in the absence of such a power in the articles a special resolution may become necessary to authorise the alteration and then under the authority of such a resolution the requisite resolution for consolidation may be passed.

Where a company's capital is restated in its equivalent in decimal currency it does not amount to an alteration of the memorandum of association as it is merely a change of label, so to speak. No formalities are required for effecting such a change. But where the conversion is not a mere change of label but affects the intrinsic value also, consolidation into exactly convertible units will be the only mode of conversion and the formalities therefor must be observed. See *Harris & Sheldon Group Ltd., Re,* (1971) 2 All ER 87n (Ch D).

Meaning of stock and conversion of shares into stock and *vice versa* [Sub-sec. (1)(c)]

Stock is the aggregate of fully paid shares legally consolidated, portions of which aggregate may be transferred or split up into fractions of any amount, without regard to the original nominal amount of the shares. *Morrice v. Aylmer,* (1875) LR 7 HL 717, 724.

This clause enables a company limited by shares or limited by guarantee with a share capital, if so authorised by the articles, to alter the conditions of its memorandum for converting the whole or any of its paid-up shares into stock or *vice versa.*

Stock cannot validly be issued directly, even against payment of full nominal amount in cash. Shares must first be issued and paid-up in full and then converted into stock. *Home and Foreign Investment and Agency Co., Re,* (1912) 1 Ch 72. Such a direct issue of stock is, however, an irregularity only, which may be cured by lapse of time, (*ibid*); but a direct issue of stock either as a bonus without any payment or against part payment is

ultra vires and wholly void and the holders cannot be placed on the list of contributories in winding-up (*ibid*). As for the differences and resemblances between shares and stock, see *Morrice v. Aylmer,* (1874) 10 Ch App 148 and Notes under S. 96, *infra*.

The effect of conversion is that the holders of stock are to have, according to the amount of stock held by them, same rights, privileges and advantages as regards dividends, voting *etc.*, as the articles may provide, as if they are still holding the shares from which the stock originated and no more. Warrants to bearers can then be issued in respect of the stock. *Pilkington v. United Rly. of the Havana and Regla Warehouses Ltd.,* (1930) 2 Ch 108.

Sub-division of shares [Sub-sec. (1)(d)]

A company may sub-divide its share capital if so authorised by its articles. It is done by an ordinary resolution passed in general meeting, *e.g.* the shares of Rs. 100 may be sub-divided in 10 shares of Rs. 10 each. Such a change, commonly called a share split, is some times made by a company in order to widen the ownership of its shares. The sub-division must be such that the proportion between the amount paid and the amount if any unpaid on each sub-divided shares is the same as it was in the case of shares from which reduced share is derived. While a Table A company can do so by an ordinary resolution, an unlimited company would have to alter its capital clause for this purpose by a special resolution. Consolidation and sub-division may be effected by the same resolution, provided that the result does not involve fractional holdings. *North Cheshire Brewery Co. Ltd., Re.,* (1920) 64 Sol Jo 463 : 1920 WN 149.

Freedom to determine denomination of shares for public/rights issue and to change the standard denomination—SEBI Guidelines, 2000

§ For Notes see under section 56 *ante*. For text of SEBI Guidelines, 2000 refer *Appendix* 162.

Sub-division of shares into shares of smaller amount

Department's view.—The consolidation of the equity share capital and the redeemable preference share capital and the division of the consolidated share capital into equity shares of lesser amount, is not covered under S. 94(1)(*b*) since the consolidation and division of share capital into shares of small denominations are not covered thereby. In the circumstances, there is no need for Form No. 5 or Form No. 6. The company should, however, move the court under S. 391 since a reorganisation of share capital will be an arrangement under S. 390(b). The change in the share capital can be given effect to in the balance-sheets only after its confirmation by the High Court under S. 391 and any further increase in the authorised capital of the company can be effected thereafter. *Department's Letter No.* 40/3/71-CL-III, dated 21-7-1975.

The tedious court route suggested by the Department could easily be avoided by a little thought. Even though Sec. 94(1)(b) talks of consolidation into shares of larger amount only, Sec. 94(1)(c) permits sub-division of shares. Hence shares could first be consolidated into shares of a larger amount under clause (*b*) and then be sub-divided into shares of smaller amount under clause (*d*). For example, two shares of Rs. 15/- each can be consolidated into one share of Rs. 30/-, which can then be sub-divided into three shares of Rs. 10/- each.

Cancellation of shares not taken up by any person [Section 94(1)(e)]

Sub-division of shares and cancellation of unissued shares or shares issued but not taken up by any person may be effected without seeking confirmation of the court. But a cancellation not within para (e) of sub-section (1) cannot be carried out without confirmation of the Court. *Re, Castiglione Erskine & Co. Ltd.,* (1958) 2 All ER 455 : (1958) 28 Com Cases 452 (Ch D).

Under section 94 sub-s. (1) it is open to a limited company to cancel shares which have not been taken or agreed to be taken by any person but an ordinary resolution for such cancellation is required to be passed by the company in general meeting under section 94(2). *Surendra Maganlal Mehta v. Reliance Textile Ind. Ltd.,* (1982) 3 Comp LJ 103 (Bom).

The exercise of power of a company to cancel the unissued shares cannot be restrained by an injunction. It is not the function of the court to interfere with the Company's power to consider a resolution for cancelling the unissued portion of its share capital. The court observed *per curium* that a Company would only be prevented from cancelling shares where a person had entered into a Contract to take the shares in question. The mere fact that some body had unilaterally consented to taking shares would not mean that the company had agreed to allot him the shares. *Swindon Town Football Co. Ltd.,* 1990 BCLC 467 (Ch D).

This sub-section does not limit other methods of reducing capital which can be attempted with the confirmation of the court. Unissued capital as well as issued capital which has not been taken up can be cancelled.

Registration fees on cancellation followed by increase

Departmental Clarification.—When a Company passes two resolutions, one cancelling unissued shares of a particular class and two, increasing the authorised capital by creating unclassified shares of the same denomination, the question arises as to whether the increase in authorised capital requires further payment of registration fees. The Department has clarified that so long as the original authorised capital, on which a Company has already paid the prescribed fees is not exceeded, the Company should not be called upon to pay any further fees. (*Circular Letter No.* 8/13/(94)/59-PR, dated 12-2-1960). From the circular, it seems that it is not limited to the cases where the subsequent increase in authorised capital comes immediately after the cancellation. Full text of the circular is reproduced below:

Text of Circular.—*Query:* A company passed two resolutions under clauses (e) and (a) respectively of sub-section (1) of section 94 diminishing the authorised capital by the cancellation of a class of its unissued shares and creating at the same time in lieu thereof unclassified shares of the same denomination. No increase in the original authorised capital was thus effected. The question for consideration is whether the creation of such new shares, concurrently with the cancellation of certain unissued share capital of a company, should be deemed to be an "increase" in the authorised capital of the company over the reduced authorised capital (due to the cancellation of shares), and if so, whether the company should be called upon to pay registration fees therefor at the time of reporting the transaction in Form Nos. 5 and 6 of the Companies (Central Government's) General Rules and Forms.

Answer: In such a transaction, so long as the original authorised capital, on which the company had already paid the prescribed fees under the Companies Act, is not exceeded, the company should not be called upon to pay any further fees. It would, however, be required to file both Form Nos. 5 and 6 to facilitate completion of the records of the Registrar. (*Circular No.* 8/13(94)/59-PR, dated 12-2-1960).

Registration fee as capital expenditure.—Fee paid to the ROC for registering increase of capital is in the nature of capital expenditure irrespective of the fact whether an increased capital will lead to increase in profits. *Punjab State Industrial Development Corpn. Ltd. v. CIT,* (1997) 26 Corpt LA 333 : (1997) 10 SCC 184.

Restructuring of capital by paying dividend in kind

A scheme was for the distribution of the shares of a group company to the members of the holding company in lieu of dividend. The question arose whether this in specie dividend constituted capital or income of the shareholders. The court first stressed the normal rule which is that all cash distributions by a company, subject to a few exceptions, are to be treated as income and not capital. In applying this rule, no distinction is to be drawn between a distribution in money and one in money's worth. But on the facts, the court said that the reorganisation of the holding company did not involve a distribution of income but was a capital reconstruction in which one capital asset in the hands of the shareholder, namely, shares in the holding company, were replaced by two capital assets, namely, the holding company's and the newly created subsidiary's shares. Accordingly, the shares which the shareholders were to receive were a part of the capital and not income. *Sinclair v. Lee,* (1994) 1 BCLC 286 (Ch D). As to this Lord REID summarised the position in *Rae v. Lazard Investment Co. Ltd.,* (1963) 1 WLR 555 at 565: ".....there is no doubt that every distribution of money or money's worth by an English company must be treated as income in the hands of the shareholders unless it is either a distribution in a liquidation, a repayment in respect of reduction of capital (or a payment out of a special premium account) or an issue of bonus shares (or it may be bonus debentures)." In *Briggs*

v. IRC, (1932) 17 TC 11, it was held that to the extent to which the distribution represented a distribution of current or accumulated profits, it was income assessable to supertax.

Splitting and consolidation fees.—See *Clauses 4 to 9* of the Listing Agreement at *Appendix* 252.

Notice to Registrar

Whenever any of the above power is exercised, section 95 comes into play and would require notice to be given to the Registrar. For details, see under S. 95.

Secretarial Practice Notes : Power to alter share capital

Check whether the company had altered the conditions of its memorandum as regards share capital in any one of the ways mentioned in section 94(1)? If so, check that:

(i) Form 5 along with the requisite fees filed with the Registrar?

(ii) the alteration was authorised by the articles and the general meeting.

(iii) the alteration had been effected in copies of Memorandum, Articles, *etc.*

Documents Involved: 1. Memorandum and Articles, 2. Minutes of the Board/General Meeting, 3. Register of Members, 4. Form No. 5.

[1][**S. 94-A. Share capital to stand increased where an order is made under section 81(4).**—(1) Notwithstanding anything contained in this Act, where the Central Government has, by an order made under sub-section (4) of section 81, directed that any debenture or loan or any part thereof shall be converted into shares in a company, the conditions contained in the memorandum of such company shall, where such order has the effect of increasing the nominal share capital of the company, stand altered and the nominal share capital of such company shall stand increased by an amount equal to the amount of the value of the shares into which such debentures or loans or part thereof has been converted.

(2) Where, in pursuance of an option attached to debentures issued or loans raised by the company, and public financial institution proposes to convert such debentures or loans into shares in the company, the Central Government may, on the application of such public financial institutions, direct that the conditions contained in the memorandum of such company shall stand altered and the nominal share capital of such company shall stand increased by an amount equal to the amount of the value of the shares into which such debentures or loans or part thereof has been converted.

(3) Where the memorandum of a company becomes altered, whether by reason of an order made by the Central Government under sub-section (4) of section 81 or sub-section (2) of this section, the Central Government shall send a copy of such order to the Registrar and also to the company and on receipt of such order, the company shall file in the prescribed form[2], within thirty days from the date of such receipt, a return to the Registrar with regard to the increase of share capital and the Registrar shall, on receipt of such order and, return, carry out the necessary alterations in the memorandum of the company.]

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1. Ins. by Act 41 of 1974, s. 11 (w.e.f. 1-2-1975).
2. Form No. 5 of the Companies (Central Government's) General Rules & Forms 1956 is the prescribed form of return.

NOTES

Companies (Amendment) Act, 1974

Increase of share capital on converting loans into capital.—This section was inserted by the Companies Amendment Act, 1974. Section 11, and the Notes on clauses stated :— This clause is of a procedural nature and dispenses with the necessity of passing a resolution for alteration of the memorandum and filing with the Registrar of Companies of the requisite documents showing increase of share capital, in certain cases. It is, however, required by this clause that the Registrar shall be informed by the Government itself in such cases, so that the Registrar may carry out the necessary alteration in the memorandum of the company showing the increase of share capital." (*Clause* 9).

Scope of section

It is presumed that, on the Registrar carrying out the necessary alterations in the memorandum, the company also should embody the alteration in all copies issued by it to shareholders and others under section 40.

It is, however, difficult to understand why in all cases where the Central Government directs that any debenture or loan is converted by an order of the Central Government under sub-section (4) of section 81, the nominal share capital should stand increased. If the conversion is within the limits of the existing nominal share capital, there is no reason why the nominal share capital should be increased further. Sub-sec. (1) takes the precaution of saying that "where such order has the effect of increasing the nominal share capital", sub-sec. (2) does not employ these precautionary words.

Policy guidelines of Government relating to stipulation in convertibility clause

Government has framed the guidelines relating to the conversion of the loans granted by the financial institutions into equity and the appointment and the role of nominee—directors of the financial institutions of the assisted Companies. These guidelines are reproduced in *Appendix* 271.

Prescribed Form and Fees.—In cases where the authorised share capital stands increased by reason of an order of the Central Government, it is not made clear under sub-section (3) as to who is to pay the additional fees that may become payable under Schedule X.

But, as the duty to file a return in the prescribed form (Form 5) within thirty days has been imposed on the company, it would appear that the duty to pay the fee prescribed therefor must also by necessary implication be paid by the company. For Form No. 5 refer *Appendix* 1.

ICSI Guidance Note on Compliance Certificate (August, 2003)

The ICSI has issued a Check List for issue of Compliance Certificate under proviso to Sec. 383A(1) in respect of the matters specified under Rule 3 of the Companies (Compliance Certificate) Rules, 2001.

Paragraph 2 under Rule 3 relates to filing of Forms and Returns with the ROC, RD, Central Government, CLB and other authorities and reads as follows:

Paragraph 2.—**The company has duly filed the forms and returns as stated in Annexure "B" to this certificate, with the Registrar of Companies, Regional Director, Central Government, Company Law Board or other authorities within the time prescribed under the Act and the Rules made thereunder.**

Prescribed Check List

Notice of redemption, consolidation , etc.

See under sec. 95.

§ For the text of the Companies (Compliance Certificate) Rules, 2001, see *Appendix* 38.

§ For the full text of the Guidance Notes on Compliance Certificate and for Specimen Compliance Certificate Form as issued by ICSI see *Appendix* 312.

S. 95. Notice to Registrar of consolidation of share capital, conversion of shares into stock, *etc.*—(1) If a company having a share capital has—

(a) consolidated and divided its share capital into shares of larger amount than its existing shares;

(b) converted any shares into stock;

(c) re-converted any stock into shares;

(d) sub-divided its shares or any of them;

(e) redeemed any redeemable preference shares; or

(f) cancelled any shares, otherwise than in connection with a reduction of share capital under sections 100 to 104;

the company shall within [1][thirty days] after doing so, give notice[2] thereof to the Registrar specifying, as the case may be, the shares consolidated, divided, converted, sub-divided, redeemed or cancelled, or the stock reconverted.

(2) The Registrar shall thereupon record the notice, and make any alterations which may be necessary in the company's memorandum or articles or both.

(3) If default is made in complying with sub-section (1), the company and every officer of the company who is in default, shall be punishable with fine which may extend to [3][*five hundred rupees*] for every day during which the default continues.

NOTES

Eng. Act, 1948 : Sec. 62. Previous Act : Secs. 50 (4) and 51.
Eng. Act, 1985 : Sec. 122.

Companies (Amendment) Act, 1965

The only substantial change in the section brought about by the Amendment Act of 1965, is that the time for giving notice to the Registrar is now thirty days instead of fifteen days; and further the section is brought in line with the English provision as to the matters regarding which the notice is to be given.

Companies (Amendment) Act, 2000

Penalty enhanced.—The Amendment Act of 2000 enhanced the penalty amount from 50 rupees to 500 rupees under sub-section (3).

Penalty for default [Sub-section (3)]

For default in complying with sub-section (1), the company and every officer thereof, who is in default, is punishable with fine which may extend to five hundred rupees for every day during which the default continues.

Compoundable offence.—The offence is compoundable under section 621A.

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1. The words "thirty days" were substituted for the words "one month" by the Companies (Second Amendment) Act (XXXI of 1965), s. 62 and Sch. (w.e.f. 15-10-1965).
2. Form No. 5 of the Companies (Central Government's) General Rules & Forms 1956 is the prescribed form of return.
3. The words "fifty rupees" substituted by the Companies (Amendment) Act, 2000 (53 of 2000), s. 41 (w.e.f. 13-12-2000).

Prescribed Form.—For form of notice to the Registrar, see Form No. 5 in *Appendix* 1.

ICSI Guidance Note on Compliance Certificate (August, 2003)

The ICSI has issued a Check List for issue of Compliance Certificate under proviso to Sec. 383A(1) in respect of the matters specified under Rule 3 of the Companies (Compliance Certificate) Rules, 2001.

Paragraph 2 under Rule 3 relates to filing of Forms and Returns with the ROC, RD, Central Government, CLB and other authorities and reads as follows:

***Paragraph 2.*—The company has duly filed the forms and returns as stated in Annexure "B" to this certificate, with the Registrar of Companies, Regional Director, Central Government, Company Law Board or other authorities within the time prescribed under the Act and the Rules made thereunder.**

Prescribed Check List

Notice of redemption of preference shares, consolidation, division, increase in share capital, cancellation of shares and increase in number of members

Check whether :

(i) the requisite notice in Form No. 5 was filed within 30 days from the day on which any of the aforesaid events occurred or resolution passed as the case may be; and

(ii) requisite registration fees have been paid on the difference between the increased capital and the existing authorised capital at the existing rate.

• *Check further* whether necessary alteration has been carried out in the Memorandum and Articles of Assocation.

§ For the text of the Companies (Compliance Certificate) Rules, 2001, see *Appendix* 38.

§ For the full text of the Guidance Notes on Compliance Certificate and for Specimen Compliance Certificate Form as issued by ICSI see *Appendix* 312.

S. 96. Effect of conversion of shares into stock.—Where a company having a share capital has converted any of its shares into stock, and given notice of the conversion to the Registrar, all the provisions of this Act which are applicable to shares only, shall cease to apply as to so much of the share capital as is converted into stock.

NOTES

Eng. Act, 1948 : Sec. 63.
Eng. Act, 1985 : Sec. 123.

Previous Act : Sec. 52.

Nature of 'Stock' and its comparison with 'Shares'

The difference between shares and stock has been likened to the difference between peas and water. Shares cannot be dealt with in fractions of their face value but stock can be split up into as many parts and sub-divided into such fractions as are desired. Stock is simply a set of shares put together in a mass, with the peculiarity that they can be fractionally dealt with. *Morrice v. Aylmer,* (1875) LR 7 HL 717. Stock is expressed in terms of money and is transferable in units of money. However, the articles may give the Board of directors power to fix the minimum amount of stock transferable and to restrict the transfer of fractions of that minimum, *e.g.*, Table A reg. 37 (proviso). Shares can be converted into stock only when they are paid-up because it would be inconvenient to have liability on shares split into fractions. Shares are not necessarily converted to stock.

Shares converted to stock may be re-converted. Conversion and re-conversion is by ordinary resolution of the general meeting.

Under Table A the rights of holders of stock are defined. There will be no voting on stock which represents a fraction of a share. For example, a holding of 20 shares' worth of stock, plus some small fractional amount, will carry votes as for 20 shares : Table A, reg. 38. But stock representing fractions of shares counts for participation in dividends and profits and in the assets on a winding up. Table A, reg. 38.

Conversion of shares to stock was formerly advantageous to shareholders when shares were commonly issued with a large par value. For a company, conversion to stock was useful to avoid record keeping occasioned by the requirement that shares unlike stock had to be numbered consecutively.

As to the meaning of stock and the circumstances in which and formalities by which shares can be converted into stock, see Notes under S. 94(1)(c).

As regards conversion of shares into stock and rights, privileges, *etc.*, of stock holders, see, Articles 36, 37, 38 and 39 of Table A of Schedule I and Notes thereunder. These Articles deal with transfer of stock, entries in register of members, annual returns and numbering of stock certificates. See also, Notes under section 2, clause (12).

It must, however, be noted that only fully paid shares can be converted into stock under S. 94(1)(c). See Notes under S. 94(1)(c).

S. 97. Notice of increase of share capital or of members.—(1) Where a company having a share capital, whether its shares have or have not been converted into stock, has increased its share capital beyond the authorised capital, and where a company, not being a company limited by shares, has increased the number of its members beyond the registered number, it shall file with the Registrar, notice[1] of the increase of capital or of members within [2][thirty] days after the passing of the resolution authorising the increase; and the Registrar shall record the increase and also make any alterations which may be necessary in the company's memorandum or articles or both.

(2) The notice to be given as aforesaid shall include particulars of the classes of shares affected and the conditions, if any, subject to which the new shares have been or are to be issued.

(3) If default is made in complying with this section, the company, and every officer of the company who is in default, shall be punishable with fine which may extend to [3][*five hundred rupees*] for every day during which the default continues.

NOTES

Previous Act : Sec. 53.

Eng. Act, 1948 : Sec. 63.
Eng. Act, 1985 : Sec. 123.

Companies (Amendment) Act, 2000

Penalty enhanced.—The Amendment Act of 2000 enhanced the penalty amount from 50 rupees to 500 rupees under sub-section (3).

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1. Form No. 5 of the Companies (Central Government's) General Rules & Forms 1956 is the prescribed form of notice.
2. The word "thirty" substituted for the words "fifteen" by the Companies (Second Amendment) Act (XXXI of 1965) (w.e.f. 15-10-1965).
3. The words "fifty rupees" substituted by the Companies (Amendment) Act, 2000 (53 of 2000), s. 42 (w.e.f. 13-12-2000).

Scope of section

For purposes of this section, where a special resolution has been passed increasing the share capital, notice of the increase must be given to the Registrar, even though the new shares may not have been 'issued, to any shareholder. *Mahalaxmi Mills Co. Ltd. v. State,* (1969) 39 Com Cases 347 : AIR 1968 Raj 331; *Miheer Hemant Mafatlal v. Mafatlal Industries Ltd.,* (1987) 89 Bom LR 86 (Bom).

A deposit of money by a director as a qualification for directorship does not increase the capital of the company. *Saraswathi Vilasam Shanmughanandha Nidhi Ltd. v. Daivasigamani Mudaliar (V.S.),* (1951) 21 Com Cases 85 : AIR 1951 Mad 520. If the share capital increases as a result of amalgamation, the transferee company has to pass a resolution of its Board of directors and has to file it with the ROC. *Shaily Engineering Plastics Ltd., Re,* (2003) 42 SCL 115 (Bom).

Ratification by board of shareholders' action in increasing capital

In the ordinary course of things the need and occasion for increasing capital is a managerial decision and, therefore, the decision must be that of the Board of directors. But when they approve or ratify a resolution passed by shareholders at their meeting without referring to them, it becomes the directors' decision. *V.M. Rao v. Rajeswari Ramakrishnan,* (1987) 61 Com Cases 20 (Mad).

Penalty for default [Sub-Section (3)]

For non-compliance with this section, the company and every officer of the company who is in default is punishable with fine which may extend to five hundred rupees for every day during which the default continues.

Compoundable offence.—The offence is compoundable under section 621A.

It may be noted that delay in filing Form 5 after 30 days of increase of authorised share capital attracts payment of additional fee at prescribed rates as per *Press Note* 2/95, dated 21-3-1995 [*Printed below*]

Continuing offence.—The failure to file with the Registrar Form No. 5 for giving notice of increase of capital within 30 days of the passing of the resolution to increase capital has been held to be a continuing offence. A subsequent resolution to undo the earlier resolution would not absolve anybody of the duty to file information and requisite fee on the basis of the resolution as first passed. *Amison Foods Ltd. v. ROC,* (1999) 1 Comp LJ 115 : (1999) 33 CLA 46 : 1999 19 SCL 82 : (2001) 103 Com Cases 846 (Ker).

Prescribed form.—For Form of Notice of increase of share capital and increase of number of members to be filed with the Registrar, see Form No. 5 in *Appendix* 1.

Prescribed fee.—The fee for filing Form No. 5 is the difference between the fees payable on the date of filing the notice for the registration of a company with a nominal share capital equal to the increased share capital and the fees paid, on such date, for the registration of a company with a share capital equal to the nominal share capital of the company filing the notice immediately before the increase. [*Vide* clause (3) of Schedule X].

Fixed rates of additional fee for belated filing of documents

Press Note 2/95, dated 21-3-1995.—Government has revised the additional fee payable on belated filing a documents w.e.f. 1-5-1995. The levy of fixed additional fee will be regulated according to the table given in Press Note. Any delay in filing Form No. 5 will be subject to payment of additional fee of 2% per month in case of delay upto one year and 2.5% per month in case of delay of more than one year on the amount of fee payable. For the text of the Press Note see Notes under Schedule X.

ICSI Guidance Note on Compliance Certificate (August, 2003)

The ICSI has issued a Check List for issue of Compliance Certificate under proviso to Sec. 383A(1) in respect of the matters specified under Rule 3 of the Companies (Compliance Certificate) Rules, 2001.

Paragraph 2 under Rule 3 relates to filing of Forms and Returns with the ROC, RD, Central Government, CLB and other authorities and reads as follows:

***Paragraph 2.*—The company has duly filed the forms and returns as stated in Annexure "B" to this certificate, with the Registrar of Companies, Regional Director, Central Government, Company Law Board or other authorities within the time prescribed under the Act and the Rules made thereunder.**

Prescribed Check List

Notice of redemption, consolidation, etc.

See under sec. 95.

§ For the text of the Companies (Compliance Certificate) Rules, 2001, see *Appendix* 38.

§ For the full text of the Guidance Notes on Compliance Certificate and for Specimen Compliance Certificate Form as issued by ICSI see *Appendix* 312.

S. 98. Power of unlimited company to provide for reserve share capital on re-registration—An unlimited company having a share capital may, by its resolution for registration as a limited company in pursuance of this Act, do either or both of the following things, namely:—

(a) increase the nominal amount of its share capital by increasing the nominal amount of each of its shares, but subject to the condition that no part of the increased capital shall be capable of being called up except in the event and for the purposes of the company being wound-up;

(b) provide that a specified portion of its uncalled share capital shall not be capable of being called up except in the event and for the purposes of the company being wound-up.

NOTES

Eng. Act, 1948 : Sec. 64. Previous Act : Sec. 68.
Eng. Act, 1985 : Sec. 124.

As to registration of an unlimited company as a limited company, see section 32.

One point to be noted here is that where the resolution includes a provision to increase the nominal share capital by increasing the nominal value of the shares, the resolution may also provided that no part of the increase shall be called by except for purposes of winding up; and the resolution may further provide that a specified portion of the existing unpaid share capital shall not be capable of being called up except for purposes of winding up, that is to say, the company may create reserve capital at the same time as it limits its future liabilities.

S. 99. Reserve liability of limited company.—A limited company may, by special resolution, determine that any portion of its share capital which has not been already called up shall not be capable of being called up, except in the event and for the purposes of the company being wound up, and thereupon that portion of its share capital shall not be capable of being called up except in that event and for those purposes.

NOTES

Eng. Act, 1948 : Sec. 64
Eng. Act, 1985 : Sec. 120

Previous Act : Sec. 69

Meaning and effect of reserve capital

If a company has issued shares but there is part of their par value which has not been called by the company, that uncalled capital is an asset of the company which the company may use as security to raise loans. *Re, Anglo Australian Investment Finance & Land Co. Ltd.,* (1895) AC 244. If, having charged its uncalled capital, the company later calls up capital, the money received is applied first in paying off the mortgage debt. In a winding up the unsecured creditors may find that uncalled capital is not available for payment of their debts. If it is desired that unsecured creditors should not be prejudiced in that way, the company's power to call up capital can be restricted irrevocably by the members passing a special resolution to determine that all or part of the uncalled capital shall not be called up until the company is wound up. Any purported charge on such reserve capital is ineffective to give the chargee any priority over other creditors. *Re, Mayfair Property Co.,* (1898) 2 Ch 28. Such a capital cannot be dealt with by the directors in any other way nor it can be turned into ordinary capital without leave of the court (*ibid*). Reserve capital once created cannot be unreserved but may be cancelled on a reduction of capital. *Midland Rly. Carriage and Wagon Co., Re,* (1907) WN 175. It is not thought that it can be paid-up by a bonus issue.

The language of the last portion of section 99, *viz.*, "and thereupon that portion of its share capital shall not be capable of being called up except in that event and for those purposes" would seem to indicate that when once the company has determined its reserve liability by special resolution it is intended to become an irrevocable condition.

Quaere.—But why should not a company, if it so desires, and where third parties are not prejudiced, revoke one special resolution by another, especially when the reservation of liability under this section is not an unalterable condition in the memorandum within the meaning of section 13 and so may be altered either under section 16(3) or section 30?

Secretarial Practice Notes : Reserve liability of limited company

Check whether the company had created any reserve liability? If so, whether a special resolution was passed? File with ROC, Form No. 23 within 30 days from the date of passing the resolution. Ensure that such share capital is not called-up, except in the event and for the purposes of the winding up.

Documents Involved: 1. Minutes of Board/General Meeting, 2. Form 23.

Reduction of Share Capital

S. 100. Special resolution for reduction of share capital.—(1) Subject to confirmation by the [4][*Tribunal*], a company limited by shares or a company limited by guarantee and having a share capital, may, if so authorised by its articles, by special resolution, reduce its share capital in any way; and in particular and without prejudice to the generality of the foregoing power, may—

(a) extinguish or reduce the liability on any of its shares in respect of share capital not paid up;

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4. Subs. for the word 'Court' by the Companies (Second Amendment) Act, 2002 (11 of 2003), s. 14.

(b) either with or without extinguishing or reducing liability on any of its shares, cancel any paid-up share capital which is lost, or is unrepresented by available assets; or

(c) either with or without extinguishing or reducing liability on any of its shares, pay off any paid-up share capital which is in excess of the wants of the company;

and may, if and so far as is necessary, alter its memorandum by reducing the amount of its share capital and of its shares accordingly.

(2) A special resolution under this section is in this Act referred to as "a resolution for reducing share capital".

NOTES

Previous Act : Secs. 55 to 56

Eng. Act, 1948 : Sec. 66
Eng. Act, 1985 : Sec. 135

Note : As and when the Companies (Second Amendment) Act, 2002 (11 of 2003) comes into force, the power under this section shall become transferred to the Tribunal to be exercised by it in place of the High Court. The commentary should be read keeping this change in mind.

Companies (Second Amendment) Act, 2002 [11 of 2003]

The powers of Court under this section have been conferred on the Tribunal constituted under Part 1B of the Act. Consequential changes have accordingly been made in the section.

Conservation and maintenance of share capital

In the conduct of a company whose members enjoy limited liability, care has to be taken that the share capital is not reduced to the prejudice of creditors. Creditors accept the risk that the company may lose money in the ordinary course of business (*Guinness v. Land Corporation of Ireland,* (1882) 22 Ch D 349 at 375) but they are entitled to protection against reduction of the company's net assets in other ways such as return of paid-up capital to shareholders either by way of a purported dividend, by redemption of shares before a winding up, by the company dealing in its own shares, or by improperly giving financial assistance to someone to purchase the company's shares or at least in the case of a trading company by giving its assets away. A creditor needs this protection because, in the words of JESSEL MR, 'The creditor has no debtor but that impalpable thing the corporation, which has no property except the assets of the business. The creditor, therefore, I may say, gives credit to that capital, gives credit to the company on the faith of the representation that the capital shall be applied only for the purposes of the business and he has therefore a right to say that the corporation shall keep its capital and not return it to the shareholders...' *Re, Exchange Banking Co.* (*Flitcroft's* case), (1882) 21 Ch D 519 at 533-534.

Thus the rule is that a company cannot cancel an allotment of shares otherwise than (a) in the course of a reduction of capital, or (b) where it is established that the contract under which shares were allotted was affected by mistake, misrepresentation or breach of a fundamental stipulation, or (c) as part of a compromise of a *bona fide* dispute as to the existence of fraud or breach of a fundamental stipulation.

Legal protections for the creditor against improper repayment of paid-up capital or diminution of the liability of shareholders were developed in case-law in the second half of the nineteenth century. That case-law has been supplemented by legislation.

Need of and procedure for reduction

The need for reducing capital may arise in various ways, for example, trading losses, heavy capital expenses, and assets of reduced or doubtful value. As a result, the original

capital may either have become lost or a company may find that it has more recources than it can profitably employ. In either case, the need may arise to adjust the relation between capital and assets. *Indian National Press (Indore) Ltd., In re,* (1989) 66 Com Cases 387, 392 (MP).

The Supreme Court in *Punjab Distilleries India Ltd. v. CIT,* (1965) 35 Com Cases 541, 544 summed-up the process of reduction thus : " *First,* there will be a resolution by the general body of a company for reduction of capital by distribution of the accumulated profits amongst the shareholders. *Secondly,* the company will file an application in the court for an order confirming the reduction of capital. *Thirdly,* after it is confirmed, it will be registered by the Registrar of Companies. *Fourthly,* after the registration the company will issue notices to the shareholders inviting applications for refund of the share capital and *fifthly,* on receiving the applications the company will distribute the said profits". To the same effect *Homi Cowasji Bharucha v. Arjun Prasad,* (1957) 27 Com Cases 6 (Pat).

Power of reduction of share capital

For a company to reduce its share capital in any manner set out in this section, it must have power given to it under its articles to do so. An authority to do so given by the memorandum of association is of no avail. *Re, Dexine Patent Packing & Rubber Co.,* 1903 WN 82. If the articles do not contain any provision for reduction of capital, the articles must first be altered so as to give the power and then the resolution for reducing capital must be passed, as a special resolution and the reduction effected by such resolution must be confirmed by the court. *West India & Pacific Steamship Co., Re,* (1868) LR 9 Ch App 11. A resolution for reduction agreed to by all the members entitled to vote is effective without a meeting. *Pearce Duff & Co. Ltd., Re,* (1961) 31 Com Cases 251 : (1960) 3 All ER 222, but as a matter of practice, courts generally insists upon the decision to be taken by a special resolution at a meeting. *Barry Artist Ltd., Re,* 1985 BCLC 283; *Khattar Electrical Eng. & General Supply Co. Ltd., Re,* (1938) 8 Com Cases 314 (Pesh).

In exercising its power the Court will have due regard to the interests of creditors, who may consent or object to the reduction.

Modes of reduction [Sub-section (1)]

The Act does not prescribe the manner in which the reduction of capital is to be effected. Nor is there any limitation of the power of the court to confirm the reduction except that it must first be satisfied that all the creditors entitled to object to the reduction have either consented or been paid or secured. *British and American Trustee and Finance Corpn. v. Couper,* (1894) AC 399, 403; *Re, Credit Assurance and Guarantee Corpn.,* (1902) 2 Ch 601; *Poole v. National Bank of China Ltd.,* (1907) AC 229; *Re, Louisiana and Southern States Real Estate and Mortgage Co.,* (1909) 2 Ch 552; *Re, Thomas de la Rue & Co.,* (1911) 2 Ch 361.

The power of reduction is general, and extends to every possible mode of reducing capital, including the cancellation of uncalled capital which under section 99 can only be called up in a winding up, the surrender for re-issue of unpaid shares obtained by subdividing partly paid shares into shares of smaller amount and attributing the whole of the amounts paid-up to the shares not to be surrendered, the repayment of paid-up capital, which is in excess of the wants of the company, upon the footing that the amount repaid shall be liable to recall, the cancellation of unissued capital which might, if authorised by the company's articles, making fully paid shares not fully paid, returning the amount to the members and simultaneously paying up the shares in full by a capitalisation of reserves. BUCKLEY ON THE COMPANIES ACTS 178, 179 (14th Edn., Vol. I).

Every possible way of effecting a reduction and any arrangement concerning the company's capital which has the effect of reducing it is within the purview of this section, *Bhimbhai v. Ishwardas,* (1894) ILR 18 Bom 152. Even available profits can be used for paying out shareholders and thereby wiping out capital which is in excess of require-

ments. *Punjab Distilling Industries Ltd. v. CIT,* (1965) 35 Com Cases 541, 549 : AIR 1965 SC 1562.

Thus the power is of general nature and without prejudice to its generality sub-section (1) cites the following three types by way of examples of reduction:

(1) it may reduce or altogether extinguish the liability on any unpaid or partly paid-up shares;

(2) it may, by reducing the face value of any shares or otherwise, cancel any paid-up share capital which is lost or cancel it to the extent to which there is found deficiency in available assets;

(3) it may pay off any paid-up share capital which is found to be in excess of the capital requirements of the company.

All these types including repayment of capital require sanction of court in advance, for there can be no retrospective approval in the matter of reduction of share capital. *Alexander Henderson Ltd., Re,* (1967) SLT (Notes) 17 (Scottish).

Reduction of capital in the following ways is permissible under the Act:

(1) diminishing the nominal amount of the shares so as to leave a less sum unpaid;

(2) diminishing the nominal amount of any shares by writing off or repaying paid-up capital;

(3) diminishing the nominal amount by combining both (1) and (2);

(4) diminishing the number of shares by extinguishing the existing liability on certain shares, writing off or repaying the whole amount paid-up thereon, and cancelling them.

Where a director himself without Board's authority cancelled the liability of a subscriber who was unable to pay calls in respect of his shares and the company having subsequently gone into liquidation, it was held that the subscriber remained liable as a contributory. *Bhulabhai v. Gopalrav,* (1905) 7 Bom LR 291.

Section exhaustive of all kinds of reduction

All reductions of capital, whether effected in any of the ways aforesaid or in any other way, fall within the provisions of this section and must follow the procedure prescribed herein, except that any cancellation of unallotted shares and the consequent diminution in the amount of the issued share capital as provided in section 94(1)(e) and (3) are not to be deemed to be a reduction of share capital. Also reduction of share capital resulting in the following cases does not fall within the scope of this section:

(1) Where a company cancels shares which have not been taken or agreed to be taken (See Notes under section 94). This is not, however, deemed to be a reduction of capital.

(2) Where shares are forfeited for non-payment of calls.

In these cases confirmation or sanction of the Court is not necessary.

The view expressed in the case of *Panruti Industrial Co. (Private) Ltd., In Re,* AIR 1960 Mad 537, to the effect that the expression 'reduction of share capital' in this section applies to all cases of reduction, whether of nominal, issued or unissued and if issued, whether paid-up or not, *does not seem to be correct* to the extent that it has failed to consider the effect of section 94(3).

A limited company not in liquidation can make no payment by way of return of capital to its shareholders except through a reduction of capital sanctioned by court. Any other distribution of money, whether called dividend or bonus or any other name can only be by way of dividing profits. *Hill v. Permanent Trustee Co. of NSW Ltd.,* (1930) AC 720; *Re, Seechiari, Argenti v. Sechiari,* (1950) 1 All ER 417.

Where a large number of shareholders defaulted in payment of the outstanding allotment money and in order to make the shares fully paid the company passed a special

resolution for reduction of capital to the extent of the unpaid amount, and inspite of publication of the notice of the petition in newspapers and Gazette, none of the shareholders or creditors appeared to oppose the petition, it was held that the reduction as effected by the resolution was to be confirmed. *Om Metals & Minerals Ltd. Re,* (2003) 43 SCL 381 (Raj).

Mode of reduction is domestic question

"The general rule is that the prescribed majority of the shareholders are entitled to decide whether there should be a reduction of capital, and, if so, in what manner and to what extent it should be carried into effect. When the reduction is consequent on a change in the method of carrying on the company's business, it is for the shareholders to decide to what extent its capital is in excess of its wants, and on the adequacy of the consideration for the reduction of their share capital, but the powers of the shareholders must be exercised so as to safeguard the rights of creditors, the just and equitable treatment of shareholders and the interest of the investing public." These principles are **affirmed** in *British & American Trustee & Finance Corporation v. Couper,* 1894 AC 399 (HL); *Poole v. National Bank of China,* 1907 AC 229; *Caldwell & Co. Ltd. v. Caldwell,* 1916 SC 120 (HL); *Re, De La Rue (Thomas) & Co. Ltd.,* (1911) 2 Ch 361." Per LORD NORMAND in *Westburn Sugar Refineries Ltd.,* (1951) 1 All ER 881 (HL).

Where an arrangement or compromise involves a reduction of share capital for which other provisions of the Act prescribe special formalities such as, a special resolution and 21-day notice, they must be complied with before the meeting. *Homi Cowasji Bharucha v. Arjun Prasad,* (1957) 27 Com Cases 6 : AIR 1956 Pat 364; *In re, Imperial Chemical Industries Ltd.,* (1936) 2 All ER 463; *In re, Khattar Electrical Engineering and Supply Co.,* (1938) 8 Com Cases 314 (Pesh).

The court may sanction a reduction in capital without insisting on proof of loss of capital but where the petition is based on this ground, the court will insist on at least *prima facie* proof of loss of capital. *Caldwell v. Caldwell & Co. (Paper makers) Ltd.,* 1916 WN 70 (HL), **followed** in *Marwari Stores Ltd. v. Gouri Shankar Goenka,* (1936) 6 Com Cases 285 : AIR 1936 Cal 327 and by the Bombay High Court in *Re, Sardesai Brothers Ltd. Company Petition* 123 of 1968, decided on 25-4-1969. **Affirmed** by the Division Bench in Appeal No. 71 of 1969 decided on 2-9-1974 **(Unreported).**

Capital is not lost unless it is permanently lost. *Barrow Haematite Steel Co., In re,* (1901) 2 Ch 746; *Welsbach Incandscent Gas Light Co. Ltd., In re,* (1904) 1 Ch 87; *Jupiter House Investments (Cambridge) Ltd., In re,* 1985 BCLC 222 (Ch D); *Grosvernor Press plc., In re,* 1985 BCLC 286. However, a company may reduce its capital for any proper purpose. The court may confirm a properly authorised reduction if safeguards are observed so that creditors are not prejudiced. (*Ibid*).

In a decision of the Calcutta High Court, the business of a company was acquired on compensation and the company's liquidator, after paying off all liabilities, preference shareholders and ordinary shareholders, still had a surplus in his hands. The equity shareholders framed a scheme for reviving the company with the surplus funds. The court held that the scheme did not amount to a reduction of capital as contemplated by this section and sections 101 and 102 since both preference and equity shareholders had been paid off. *McLeod & Co. v. S.K. Ganguly,* (1975) 45 Com Cases 563 (Cal).

Motive for reduction

When exercising its discretion, the court is concerned to see that the reduction is fair and equitable *British and American Trustee and Finance Corpn. v. Couper,* (*Supra*), but is not concerned to consider the motive for the reduction; as, for example, that it was to avoid the effects of a threatened nationalisation. *Ex parte, Westburn Sugar Refineries Ltd.,* (*Supra*) or to distribute accumulated profits in such a way as to avoid or diminish liability to tax, *David Bell Ltd.,* (1954) SC 33, (**following** the case last cited and **not following** *Re, A. and D. Fraser Ltd.,* (1951) SC 394) or to provide for the payment of estate duty on the death of a large shareholder *Re, Rea Bros. Ltd.,* **unreported,** No. 00916 of

1949; *Panruti Industrial Co. P. Ltd., Re,* AIR 1960 Mad 537. In all these cases the reduction was confirmed by the court.

Many companies sometimes find it fiscally desirable to cancel the preference capital, sometimes by paying it off in cash but often by cancelling it and issuing loan stock of the same nominal amount but with a higher rate of interest to the preference shareholders or in many cases only to those who assent, leaving non-assenting holders unaffected, and many reductions effected for this purpose have been confirmed. *In re, Holders Investment Trust Ltd.,* (1971) 2 All ER 289, however, the proposed exchange of 6 per cent unsecured loan stock 1985/90 for all the issued 5 per cent redeemable preference shares, which were redeemable at par on 31 July, 1971, was, following a hearing of the petition in October, 1970, held to be unfair and the reduction was not confirmed. See BUCKLEY ON COMPANIES ACT, 181 (14th Edn., Vol. I).

While the court has to see that there was nothing unfair on inequitable in a proposed reduction, the loss would have to be borne by those who would bear it if it were a winding up. *London New York Investment Corpn., Re,* (1895) 2 Ch 860 (Ch D).

Valid special resolution

Unless a special resolution, as authorised by the articles, is passed for reduction of the share capital of a company in any way, no such reduction can be effected by the company or confirmed by the Court. In a decision of the Madras High Court, *Self Help Private Industrial Estate Private Ltd., In re,* (1972) 42 Com Cases 605 (Mad.), a learned Judge held that where a special resolution for reduction of capital was not effective, for want of 21 clear days notice for holding the meeting to pass the resolution, the subsequent obtaining of consent letters from shareholders holding more than 95% of the paid-up share capital and voting rights was sufficient to validate the resolution. With great respect to the learned Judge, it must be said that there is no warrant anywhere in the Act for holding the view that the consent of 95% of members holding not less than 95% voting rights subsequently obtained can validate a defective special resolution. Section 171(2) only provides that 'a general meeting' may be called by giving shorter notice than 21 days if consent is accorded thereto by all the members in the case of an annual general meeting or by holders of 95% voting power or 95% voting right in the case of other meetings. It does not dispense with the necessity of calling and holding the meeting for passing the special resolution in accordance with the provisions of the Act. And section 192(4) covers only cases of resolutions agreed to by all the members. Where then is the power to treat the consent of less than 100% members holding voting power or voting rights as sufficient to validate an invalid special resolution?

Where every shareholder subsequently consents to a defective resolution being treated as a valid special resolution for reduction of capital and the petition is presented on that footing, no shareholder can be heard to say that it has not been validly passed and the reduction may be confirmed. *Re, Pearce Duff & Co. Ltd.,* (1960) 3 All ER 222 : (1961) 31 Com Cases 251 (Ch D). So too, when there has been an accidental omission to give certain members notice of the meeting as per S. 172(3). *Re, West Canadian Collieries Ltd.,* (1962) 1 All ER 26; *Jaiton Stock Exchange Assn. Ltd.,* AIR 1952 Pepsu 114, where a resolution was invalid because every member was not informed, confirmation was refused.

The court is only concerned to confirm the proposed reduction and cannot go into the validity of other resolutions passed by the company. *Bengal Burma Steam Navigation Co. Ltd., In re,* (1940) 10 Com Cases 1, 7 (Rang). The court has inherent powers to rectify petty mistakes in the resolution. *In re, Willaire Systems Plc.,* 1987 BCLC 67 (CA).

Manner of effecting reduction of share capital and discretion of the court

".....the statute has not prescribed the manner in which the reduction is to be carried out nor has it prohibited any method of effecting that object." per LORD HERSCHELL, L.C., in *British & American Trustee & Finance Corporation v. Couper,* 1894 AC 399 at page 405, quoted with **approval** by LORD REID in *Re, Westburn Sugar Refineries Ltd.,*

(1951) 1 All ER 881 at page 885 who adds that "paying off capital can be done otherwise than by payment of money."

Subject to the confirmation of the Court which is required for safeguarding the interests of creditors and minority shareholders and seeing that it is fair and reasonable, the question of reducing the capital is a domestic affair to be decided by the majority, and the Act leaves the company to decide for itself the extent, mode, *etc.*, of the reduction and the application of the moneys released thereby. See *Hindustan Commercial Bank Ltd. v. Hindustan General Electric Corporation,* (1960) 30 Com Cases 367 : AIR 1960 Cal 637. See also *In re, Panruti Industrial Company (Private) Limited,* AIR 1960 Mad 537.

In its consideration of the fairness of a proposed reduction of capital of a company, the Court's jurisdiction is not confined to matters relating to the reduction alone. All circumstances relating to the adjustment of the interests of the different classes of shareholders, but not mere possibilities that may ultimately affect them, may properly be taken into account. See *Scottish Insurance Corporation v. Wilson & Clyde Coal Co. Ltd.,* (1949) 1 All ER 1068 : (1949) 19 Com Cases 202 (HL) where LORD SIMOND said: "Important though its (Court's) task is to see that the procedure, by which a resolution is carried through, is formally correct and that creditors are not prejudiced; it has the further duty of satisfying itself that the scheme is fair and equitable between the different classes of shareholders." If the directors illegally proceed to effect a reduction of capital they may be restrained by an injuction. *Holmes v. Newcastle-upon-tyne Free-hold Abatroir Co.,* (1875) 1 Ch D 682; *Hope v. International Financial Society,* (1876) 4 Ch D 327.

There may be a reduction for paying off one class of shareholders, e.g., preference shareholders, *Scottish Insurance Corporation Ltd. v. Wilsons and Clyde Coal Co. Ltd.,* (1949) 1 All ER 1068 (HL); *Re, Chatterley-Whitefield Collieries Co. Ltd.,* (1948) 2 All ER 593 (CA). **Affirmed** in (1949) 1 All ER 1094 (HL). *House of Fraser v. ACGE Investments Ltd.,* 1987 BCLC 478 (HL). See also *Re, Old Silk Stone Collieries Co.,* (1954) 1 All ER 68 or for paying off one set of shareholders such as foreign shareholders. *British and American Trustee and Finance Corporation v. Couper,* 1894 AC 399. An attempt was made to pay out from the accumulated profits, a certain amount by way of reduction of capital to the holders of ordinary shares of the company who were fully paid and not to the residue who were not fully paid. It was held that the section could not be construed as only authorising the return of capital to the whole class of shareholders among whom the accumulated profits were divisible and therefore the resolution was not *ultra vires*. The share capital in this case was reduced by transferring to the shareholders the shares of some other company. *Neale v. City of Birmingham Tramway Co.,* (1910) 2 Ch 464. In all cases the Court will consider whether the reduction is fair and equitable, though it will not be concerned with the motive for the reduction, such as the intention to avoid the effects of a threatened nationalisation, or avoid or diminish tax liability or estate duty. *Ex parte, Westburn Sugar Refineries Ltd.,* (1951) 1 All ER 881 (HL). The case law on the subject has been reviewed in *Re, Panruti Industrial Co.,* AIR 1960 Mad 537.

It is not necessary that before any burden of reduction is put on the shoulders of preference shareholders, the ordinary shares should be fully wiped out. *Maneckchowk and Ahmedabad Mfg. Co. Ltd., Re,* (1970) 40 Com Cases 819 (Guj); *Hindustan Commercial Bank Ltd. v. Hindustan General Electrical Corpn.,* (1960) 30 Com Cases 367 (Cal).

The court should not confirm a scheme of reduction which involves increase of capital to be followed by reduction unless the increase has been effected first. *Transfesa Terminals Ltd., Re,* (1987) 3 BCC 647; *Re, TIP-Europe Ltd.,* (1987) 3 BCC 647.

The court can sanction a reduction even if it amounts to a variation of class rights if the regulations are complied with and those holding a sufficient majority of that class of shares voted in favour of the reduction in the *bona fide* belief that they were acting in the interests of the general body of that class. Where it appeared that those who approved the scheme did not at all apply their minds as to whether the scheme was good for the class as a whole, confirmation was refused. *Holders Investment Trust Ltd., Re,* (1971) 2 All ER

289 (Ch D). Even in the case of capital represented by fully paid-up shares, reduction can be allowed proportionately. *In Re, House Property & Investment Co.*, (1912) 106 LT 949.

§ For further Notes see under S. 102.

Surrender of shares to company

The phrase 'surrender of shares' means the surrender to the company on the part of the registered holder of shares already issued. It does not apply to the refusal of a registered shareholder to take up newly issued shares to which he is entitled. *Ezekiel v. Carew & Co. Ltd.*, (1938) 8 Com Cases 161, 170 (Cal). Where shares are surrendered to the company, whether by way of settlement of a dispute or for any other reason, it will have the same effect as a transfer in favour of the company and amount to a reduction of capital. But if, under any arrangement, such shares, instead of being surrendered to the company, are transferred to a nominee of the company then there will be no reduction of capital; *Collector of Moradabad v. Equity Insurance Co. Ltd.*, (1948) 18 Com Cases 309 : AIR 1948 Oudh 197; "The subscribers to the memorandum who were also the first directors could not avoid their liability to pay for the shares by pleading their own default or negligence in not making the allotment of shares to themselves." *Naraindas Lahoredas, Re* (1934) 4 Com Cases 127 (Sind); *Bellarby v. Rowland & Marwood's SS Co. Ltd.*, (1902) 2 Ch 14; *Nand Kishore Bajoria v. Gaya Sugar Mills Ltd.*, AIR 1953 Pat 390. Shares bequeathed to the company will also result in reduction of capital unless such shares are taken and registered in the name of a nominee of the company. See *Re, Castiglione's Will Trusts*, (1958) 28 Com Cases 365 : (1958) 1 All ER 480.

The surrender of shares which involves no actual reduction of capital is not illegal. The reduction of capital must be actual and substantial and not theoretical and fanciful before the transaction could be successfully attacked. Each transaction must be decided on its own facts. *B.C. Red Cedar Shingle Co. Ltd. v. Stoltze Mfg. Co. Ltd.*, (1932) 1 DLR 762 (Canada). *Rowell v. John Rowell & Son Ltd.*, (1912) 2 Ch 609. A company can accept surrender of old shares in exchange for new shares with preferential rights of dividends and repayment of capital. *Eichbaum v. City of Chicago Grain Elevators Ltd.*, (1891) 3 Ch 459. A surrender of a part of company's assets, whether provident or improvident to another person who is not member is of course not a reduction of capital. *Thomson v. Trustees, Executor and Securities Insurance Corpn.*, (1895) 2 Ch 454.

§ See also Notes under S. 108 under the heading "Surrender of Shares".

Cases where reduction procedure is not called for

In the following cases the procedure under section 100 is not attracted:

(1) Where redeemable preference shares are redeemed in accordance with the provisions of sections 80 and 81.

(2) Where any shares are forfeited for non-payment of calls, though the forfeiture as a fact amounts to a reduction of capital.

(3) Where there is a surrender of shares or a gift is made to a company of its own shares. (The gift may be accepted in the name of a nominee of the company).

(4) Where the nominal share capital of a company is reduced by cancelling any shares which have not been taken or agreed to be taken by any person.

(5) Where company purchases its own shares in pursuance of the provisions in section 77A.

It may also be noted that reduction of capital and reduction of capital on shares are not prohibited in the case of an unlimited company. For the position of chitfund companies, see *Madras Native Permanent Fund Ltd. v. Natesa Sastri*, AIR 1929 Mad 773.

In *Rupak Ltd. v. ROC*, (1976) 46 Com Cases 53 (Pat), a Judge of the Patna High Court held that where an illegal allotment of shares had been made and on the allottee disputing it, the allotment was cancelled, this would amount to a reduction of share capital within the meaning of this section and the proper procedure for the company would have been to

pass a special resolution for reduction of capital. With great respect to the learned Judge, this does not appear to be a correct view. In the case of an illegal allotment of any shares, the allotment being *ab initio* void, cancellation of the allotment will only amount to a rectification of a mistake, as the shares were never subscribed or applied for. The directors themselves should have the right to rectify the mistake.

Where a sum of money was received for allotment of shares but that could not be done, paying back that money to the depositor did not require procedure for reduction of capital even though the money was shown as a part of company's subscribed capital. *Rupak Ltd. v. ROC,* (1984) 56 Com Cases 206 (Pat).

A Nidhi company was holding members deposit money as if it were a share capital. The Registrar pointed out the error and a part of the deposit money was converted into shares of rupee one each. This was held to be not a reduction of capital. *Shrivilliputtur Permanent Fund Ltd., Re,* (1952) 22 Com Cases 299 (Mad).

§ See Notes under Ss. 111(4)/155, under the heading 'Directors' power to rectify 'entries'. There is no question of any 'reduction of capital' arising in such a case.

Reduction of Share Premium Account

§ See Notes under section 78 under the same heading.

Cancellation of share premium account

A company applied for sanction of the court to a special resolution for cancellation of its share premium account. The company had three classes of shares : ordinary, cumulative preference (owned by its major shareholder) and convertible preference shares. The special resolution was passed at a meeting of the company convened by short notice of Nov. 16 and held on Nov. 19. Some transfers of shares were made in order to assure approval of short notice by shareholders. Notices were sent to ordinary and preference shareholders but one convertible preference shareholder did not receive it until the day after the meeting. The notice itself was much abbreviated, mentioning the urgency but omitted to say that the particular urgency was attributable to the need to improve US tax liabilities of the parent company of one shareholding company in the group. The company urged that the reduction was not of capital, but of the share premium account and the preference shareholders had no right to expect any benefit from the operation. The court said that the proposal has to be fair and equitable to the shareholders as a whole. The proposal did give proper account to the interests of the ordinary shareholders in the company's distributable profits and reserves whilst leaving the company in possession of assets and sources of income which were more than adequate cover for the foreseeable future for the preference shareholders' rights, as provided in the articles. Although there would be a reduction in the company's assets, given the figures, it was not one that would increase the risk of non-payment to the preference shareholders materially or in any meaningful sense. Although the procedure adopted in the interests of speed was only the bare legal minimum and the information far from forthcoming as to the true nature and background of the proposed course of aciton, the interests of the majority shareholders were to be taken into account and given that it was in fact fair to the preference shareholders and despite the shortcomings of the case, the proposal would be sanctioned by the court. Nevertheless company's conduct did not commend itself to the court and, therefore, the court said that no company would be well advised to follow the same course if it had any minority shareholders upon whose agreement it could not count. *Ransomes Plc. Re,* (1999) 1 BCLC 775 (Ch D). **Reliance** was placed in the course of arguments on the following passage in BUCKLEY ON THE COMPANIES ACT (14th edn., Vol. 1, p. 180), 'Subject, however, to the confirmation by the court, which is required, and which is the safeguard of the minority, the question of reducing capital is a domestic one for the decision of the majority, and the Act leaves the company to determine the extent, the mode, and the incidence of the reduciton and the application of any capital moneys which the reduction may set free.'

The Court of Appeal **affirmed** the decicion of the Chancery Division and said : "In brief the position is that the judge was right to sanction the cancellation on the material before him. Subsequent events have led the company and those who ultimately control it to alter their plans radically, but not in a way which deprives the cancellation of any utility, nor so as to increase the vestigial risk of prejudice to holders of preference shares. On the contrary, the risk (such as it is) is further diminished. In these circumstances there is no warrant for this court to impose on the company an unusual condition, of potentially unlimited duration, which the judge did not think necessary. *Ransames plc* (1999) 2 BCLC 591 at 604 (CA).

§ See also Notes under section 78 under the same heading.

Reduction in cases of over-capitalisation [Sub-section (1)(a)]

In cases which involve a diminution of liability or a return of paid-up capital, the procedure is more exhaustive. The replacement of preference shares by loan stock in a reduction involves payment to a shareholder of paid-up share capital within the meaning of section 101(2). *Lawrie & Symington Ltd., Petitioners,* 1969 SLT 221. In *Forthwine Ltd., Petitioners,* 1993 SLT 170 : 1991 BCC 638, it was held that the procedure of reduction could be used where the company wished to convert its ordinary shares into redeemable deferred shares which would then be redeemed. The approval of the members had been secured and if it could be shown that the creditors would not be prejudiced, the scheme could be implemented. An inquiry has to be made as to the debts and liabilities and the consent of creditors has to be obtained. [Section 101(3)-(5)]. Such creditors as do not consent must be paid off. The court may dispense with these requirements, [section 101(6)], but will only do so if the creditors would not be prejudiced. *Re, Lucania Temperance Billiard Halls (London) Ltd.,* (1966) Ch 98. In special circumstances it may even be sufficient to satisfy the court that the company holds sufficient cash and securities to cover the return of capital (if any). If the court is of the opinion that the reduction should not be confirmed it has an absolute discretion to refuse it. *Prudential Assurance Co. Ltd. v. Chatterley-Whitfield Collieries Co. Ltd.,* (1948) 2 All ER 593; *Scottish Insurance Corporation Ltd. v. Wilsons and Clyde Coal Co. Ltd.,* (1949) 1 All ER 1068 (HL). See PALMER'S COMPANY LAW, 515 (24th Edn., 1987): Para 4.315, Vol 1, 25th Edn., 1992.

Arrangement, amalgamation and reduction of capital

§ For Notes on this topic, see under section 101.

Loss of capital and its proof [Sub-section (1)(b)]

Where the sole reason for reduction is the fact that capital is lost or unrepresented by available assets, the court requires some *prima facie* evidence of such loss and that the loss is of permanent nature. If it is necessary for this purpose to prove the value of a particular asset, the valuation report of an expert mostly supported by his affidavit that the valuation is in his opinion fair and proper can relied upon. *Practice Direction,* (1947) WN 116. *In Re, Jupiter House Investments (Cambridge) Ltd.,* 1985 BCLC 222 reduction was sanctioned even though no permanent loss was shown, on faith of undertaking to place any moneys recovered to capital reserve. *In Re, Grosvenor Press Plc.,* 1985 BCLC 286 reduction was similarly sanctioned on undertaking limited to protection of existing creditors.

Where however there are some other valid reasons for reduction, it is immaterial that the proposed reduction is not exactly commensurate with the loss or deficiency of assets, such reduction being within the general words of Sub-section (1) of S. 100. *Poole v. National Bank of China Ltd.,* (1907) AC 229 (HL), with which should be compared, as to applying reserve funds in or towards wiping out losses of capital; *Re, Hoare & Co Ltd. and Reduced,* (1904) 2 Ch 208 (CA); See also, *Re, Barrow Haematite Steel Co.,* (1901) 2 Ch 746 (CA); *Poole v. National Bank of China Ltd., (Supra).*

In practice, the court requires proof of the loss. If the amount of capital to be written off as lost is more than the amount of proved loss, the court may, and probably will, direct an inquiry as to creditors. It has been held that it is unnecessary to prove that capital has been lost, or is unrepresented by available assets: *Re, Louisiana and Southern States Real Estate and Mortgage Co.,* (1909) 2 Ch 552. The real effect of *Poole v. National Bank of China Ltd., (Supra),* is that the courts need not be so strict as formerly in requiring evidence that the capital is lost or unrepresented by available assets; in *Caldwell v. Caldwell & Co. (Papermakers) Ltd.,* (1916) WN 70 (HL), LORD PARKER OF WADDINGTON, referring to this case, stated that he still thought that, where the reduction of capital was based on the ground that capital had been lost or was unrepresented by available assets, it was, though not necessary, at any rate wise and prudent to insist on some evidence of the fact *followed in Marwari Stores Ltd v. Gouri Shankar Goenka,* (1936) 6 Com Cases 285 : AIR 1936 Cal 327.

Permanent loss in this context means so far as is presently forcible and not a temporary fall in the value of a capital asset. *Jupiter House Investments (Cambridge) Ltd.,* (1985) 1 WLR 975, 978 : 1985 BCLC 222. Loss of assets does not by itself amount to reduction. Such loss would have to be adjusted by way of reduction in the value of the assets in the balance-sheet so as to impart reality to its contents, only with the sanction of the court. *Shyamapada Chakrabertty v. Controller of Insurance,* (1962) 32 Com Cases 258 : AIR 1962 SC 1355.

Examples of types of reduction of capital

The following are some of the types of reduction commonly adopted:

(1) Reduction of excess capital. North Regent Securities Ltd. (No. 00811 of 1953); Re, Blackburn Coal Stores Pty. Ltd., (1939) VLR 351.

(2) The cancellation of all the share capital as part of a scheme of arrangement. (1937) 81 SJ 922.

(3) Reduction to rectify an irregular repayment or purchase of shares by the directors. *Re, Scottish Queensland Mortgage Co.,* (1908) 46 SLR 22; *Re, York Glass Co. Ltd.,* (1889) 60 LT 744.

(4) Paying off part of the shares out of capital in excess of wants so as to enable the holders of the remaining shares in effect to acquire the interest of those paid off and become the only shareholders.

(5) Cancelling shares of two members by agreement to repay the company the loss resulting from misappropriation of funds by an official. *Re Banknock Coal Co. Ltd.,* (1897) 24 R 476. Cancelling shares surrendered, or the holders of which consent to cancellation. *Re, Llynvi, etc. Iron Co.,* (1877) 26 WR 55; *Re, Vivian & Co.,* (1886) 54 LT 384; *Poole v. National Bank of China Ltd.,* (1907) AC 229. In *Randesia Base Mineral Mining & Development Co. (Pty.) Ltd.,* (1939) WLD 291, a reduction was confirmed to rectify the payment of a dividend out of capital.

(6) Paying off or returning paid-up capital not wanted for the purposes of the company. *Re, Lees Brook Spinning Co.,* (1906) 2 Ch 394; *Re, Artisans Land and Mortgage Corpn.,* (1904) 1 Ch 796; *Re, Piercy Whitwham v. Piercy,* (1907) 1 Ch 289.

(7) Paying off unpaid-up capital by issuing debentures or debenture stock in satisfaction *Re, De La Rue & Co. Ltd. and Reduced,* (1911) 2 Ch 361. This will not be sanctioned where it would result in the company becoming wholly insolvent: *Re, Clark,* (1921) NZLR 533 or where a company is satisfied that it can finance its requirements to the extent of capital repaid by raising money or loan or borrowing from its bankers.

(8) Paying off and cancelling preference shares, in pursuance of a contract in the memorandum and articles binding on both preference and ordinary shareholders, by applying for the purpose a portion of the profits of the company. See *Re, Dicido Pier Co.,* (1891) 2 Ch 354.

(9) Reducing the liability of shareholders in respect of uncalled or unpaid capital.

(10) Reduction in excess of the wants of the company satisfied by the distribution of investments of greater value than the amount of the reduction. *Re, Westburn Sugar Refineries Ltd.,* (1951) 1 All ER 881.

(11) *Lost capital.* Cancelling capital which has been lost or is unrepresented by available assets. In such case where a company has lost part of its capital, nothing, as SIR GEORGE JESSEL said in *Ebbw Vale Steel etc. Co.,* (1877) 4 Ch D 827 can be more beneficial to the company than to admit the loss, and to write it off, *e.g.*, to reduce its £1 shares to 10s., and thus place itself in a position to resume payment of dividends, or raise further capital.

(12) Reduction to reduce all shares of a company which has lost its register of members and cancel all shares the holders of which do not signify their wish to continue as members. *Re, Kasudan Holdings Ltd., (No. 0063 of 1956).*

(13) Paying off paid-up capital on the footing that it may be called up again. *Re, Fore Street, etc., Co.,* (1888) 59 LT 214; *Re, Brown, Sons & Co.,* (1931) SC 701; *Watson-Walker & Quickfall,* (1898) WN 69; *Re, Scottish Vulcanite Co. Ltd.,* (1894) 21 R 752; *Re, Stevenson, Anderson & Co. Ltd.,* 1951 SLT 235. Repaying capital to the holders of fully paid-up shares of a class on the footing that it can be called up again so as to bring them into line with the partly paid shares of the class. *Neale v. City of Birmingham Tramways,* (1910) 2 Ch 464.

(14) Where the amount unpaid on shares was cancelled and money was raised by the issue of new shares. *Hoggan v. Tharsis Sulphur & Copper Co. Ltd.* (1882) 9 R 1191. In *Morrison (W.) & Co. Ltd.,* (1892) 19 R 1049, the court refused the reduction where the nominal amount of the shares was unaffected but the paid-up amount was reduced.

(15) *Writing off unpaid capital.*—The company proposed to cancel shares which were allotted to public but which remained unpaid. A special resolution was passed for cancellation of such shares and reduction of capital accordingly. There was no opposition to the resolution. The minute of reduction as proposed by the company was confirmed by the court. *Vantech Industry Ltd. Re,* (1999) 2 Comp LJ 47 : (1999) 20 SCL 370 (AP).

Capital in excess of wants of company [Sub-section (1)(c)]

Paid-up capital may be 'in excess of the wants of the company', notwithstanding the fact that the company wants for employment in its business the money so paid-up. The matter to be proved is not that the money but that the capital is in excess of the wants. Capital means share capital, and if the company can borrow the money upon better terms the capital may be in excess of the amount which it wants as money paid upon shares because it is preferable to borrow it. A reduction by which capital paid upon shares is to be returned to the shareholders and borrowed from them on debentures is accordingly within the Act *Re, Lamson Store Service Co.,* (1897) 1 Ch 875; *Re, Nixon's Navigation Co.,* (1897) 1 Ch 872, and such a reduction is not necessarily unfair or inequitable because the resolution for reduction renders it obligatory upon the shareholders to accept debentures in satisfaction of the capital to be returned. *Re, Thomas de la Rue & Co.,* (1911) 2 Ch 361.

The return of capital in excess of the wants of the company may be effected by transferring assets *in specie* to the shareholders, and the court will confirm such a reduction notwithstanding that the value of the assets so transferred exceeds the amount by which the capital is reduced, provided that it is satisfied that the interests of creditors, shareholders and members of the public who may have dealings with the company or may be minded to invest in its securities are safeguarded. *Westburn Sugar Refineries Ltd., Ex parte,* (1951) All ER 881 : 1951 AC 625. See, BUKLEY'S COMPANIES ACTS, Volume 1, Para 135.68, (15th Edn., 2000).

§ See also Notes under s. 392 under heading "Arrangement, amalgamation and reduction of capital".

Reduction of capital when company in winding up

The power of a limited company to reduce capital continues even after it has gone into winding up. Where the reduction is part of a scheme of arrangement, the requirement of the Companies Act as regards reduction of capital is not applicable but in other cases it must be complied with. *Cooper, Cooper and Jhonson Ltd., Re,* (1902) WN 199; *Stephen Walters & Sons Ltd.,* (1926) WN 236, *Durairajan (T.) v. Waterfall Estates Ltd.,* (1972) 42 Com Cases 563 (Mad) **followed** in *Asian Investments Ltd., Re,* (1992) 73 Com Cases 517, 523 (Mad).

Reduction of capital when company defunct

Where the company has ceased to trade, a reduction of capital cannot be prevented. *Great Universal Stores Ltd., Re,* (1960) 1 All ER 252 : (1960) 30 Com Cases 339 (Ch D).

Reduction of capital of unlimited company

An unlimited company to which section 100 does not apply can reduce its capital in any manner that its memorandum and articles of association allow. *Borough Commercial and Bldg. Society,* (1893) 2 Ch 242. It is not governed by Ss. 94 and 100 of this Act. Section 13 does not provide that its capital shall be stated in the memorandum. And even if its capital is stated in the memorandum, the Companies Act impliedly gives power to alter it.

Injunction against illegal reduction of capital

A dealing with the capital of a company which is a reduction of capital within the Act and which is not carried out in pursuance of the provisions of the Companies Act will be restrained. *Holmes v. Newcastle-upon-Tyne Freehold Abattoir Co.,* (1875) 1 Ch D 682; *Hope v. International Financial Society,* (1876) 4 Ch D 327; *Bannatyne v. Direct Spanish Telegraph Co.,* (1886) 34 Ch D 287. Where the shares have been illegally issued at a discount, the court will not confirm a reduction based upon writing off the discount as 'unprecedented by available assets'. *Re, New Chile Gold Mining Co.,* (1888) 38 Ch D 475.

Equal reduction of shares of one class

Where there is only one class of shares, *prima facie,* the same percentage should be paid off or cancelled or reduced in respect of each share, but where different amounts are paid-up on shares of the same class, the reduction can be effected by equalising the amount so paid-up. *Neal v. City of Birmingham Tramways Co.,* (1910) 2 Ch 464. The same principle is to be followed where there are different classes of shares but their rights to repayment of capital on a winding up are the same. *Bannatyne v. Direct Spanish Telegraph Co.,* (1886) 34 Ch D 287; *Credit Assurance & Guarantee Corporation Ltd.,* (1902) 2 Ch 601. The court can confirm a reduction in which only some of the shares of a class are repaid, since the question as to how any loss shall be borne or surplus distributed is a domestic one for the decision of the majority. *British & American Trustee & Finance Corpn. v. Couper,* (1894) AC 399; *Floating Dock Co. of St. Thomas Ltd., Re,* (1895) 1 Ch 691; *Pinkney & Sons Steamship Co., Re,* (1892) 3 Ch 125.

Where the members of the same class of shares have to bear different reduction, then it is necessary that all the members of the class must have consented. It has been suggested that in such circumstances it would be better to prepare a scheme of arrangement and to get it sanctioned by the court under provisions relating to arrangement, compromise *etc.* That procedure can offer better protection to the minority shareholders. *Robert Stephen Holdings Ltd., Re,* (1968) 1 WLR 522.

Paying off preference shareholders

A company's articles of association provided that the rights attached to any class of shares should be deemed to be varied by " reduction of the capital paid up on such

shares." The company proposed to reduce its capital by paying off the preference shares and cancelling them. But it did not obtain the consent of the shareholders of that class. The company argued that it did not have to obtain the class consent because reduction was something different from paying out and cancellation. The court held that the effect of the article was to make the proposed reduction and cancellation a variation of the class rights of the shareholders for which the consent of the preference shareholders was necessary. Such consent having not been obtained the reduction was not confirmed by the court. It had not been carried out in accordance with the company's articles. *Northern Engineering Industries plc. Re,* (1993) BCLC 1151 (Ch D). The Court of Appeal **affirmed** the decision of the trial judge and dismissed the appeal of the company. *Northern Engineering Industries Plc., Re,* (1994) 2 BCLC 704 (CA).

The Bombay High Court sanctioned a scheme of reduction for redemption of the company's preference shares held by two other companies. Payment was made out of profits under s. 100(1)(c). *Birla Global Finance In re,* (2004) 58 CLA 154 (Bom).

Reduction where shares of different classes

In *Re, Old Silkstone Collieries Ltd.,* (1954) 1 All ER 68, the court refused to sanction a scheme of reduction of capital involving the repayment of preference stocks at par, on the grounds, *inter alia*, that the preference shareholders had only agreed to previous reductions of capital on the basis of statements by the Board that their statutory rights to an adjustment of interests, following receipt of compensation by the company for nationalisation of its assets, would be preserved. The effect of the reduction before the court would have been to extinguish that right. The scheme of reduction was not, therefore, fair and equitable, and confirmation was refused.

In *In the Matter of Fowlers Vacola Manufacturing Co. Ltd.,* (1966) VR 97 (Aust) [noted (1966) 40 ALJ 55], the court refused to sanction a scheme of reduction because the amount in excess of the wants of the company was to be returned in its entirety to the ordinary shareholders, whereas on a winding up preference shareholders were given priority by the articles to a return of capital. The court stated that a reduction of capital by return to shareholders is *prima facie* unfair if it is made otherwise than in accordance with priorities on a winding up.

In *James Colmer Ltd.,* (1897) 1 Ch 524 the court approved such a reduction when the holders of three-quarters of the preference shares had given their consent under a provision in the articles by which the rights of the whole class might thereby be varied. It is doubtful, however, whether preference shareholders have a right to prevent the capital repaid on the ordinary shares being reduced without their consent, and so the class consent in the case cited may have been unnecessary. Where capital is reduced otherwise than by repayment or because of a loss of assets, it may be that the normal order of reduction as between different classes of shareholders does not apply, and that the reduction should be made rateably on shares of all classes without regard to their priority for repayment of capital in a winding up. In that case a reduction which is not made rateably on the shares of each class could only be carried out with the individual consents of the shareholders who are adversely affected, or with the consent of a certain fraction of the shareholders of each class under the provisions of the company's memorandum or articles or under the Companies Act, 1985, for the variation of class rights. *Carruth v. Imperial Chemical Industries Ltd.,* (1937) 2 All ER 422 at 432-3, PER LORD BLANESBURGH; *Cf.* PENNINGTON'S COMPANY LAW 231 (7th Edn., 1990). A scheme of reduction under which preference shares were repaid and cancelled was held not to amount to an abrogation of the rights of the preference shareholders. *Re, Saltdean Estate Co. Ltd.,* (1968) 3 All ER 829; see also *Re, William Jones & Sons Ltd.,* (1969) 1 WLR 146.

In Re, *The Isle of Thanet Electricity Supply Co. Ltd.,* (1949) 2 All ER 1060, WYNN-PARRY J. said: "..... In many judgments the effect of the authorities as now in force is to establish ..... two principles .....: first, that, in construing an article which deals with rights to share in profits, that is, dividend rights, and rights to share in the company's property

in a liquidation, the same principle is applicable; and, second, that that principle is that, where the article sets out the rights attached to a class of shares to participate in profits while the company is a going concern or to share in the property of the company in liquidation, *prima facie*, the rights so set out are in each case exhaustive....."

It is not necessary that before any burden of reduction is put on the shoulders of preference shareholders, the ordinary shares should be fully wiped out. *Maneckchowk and Ahmedabad Mfg. Co. Ltd. Re,* (1970) 40 Com Cases 819 (Guj); *Hindustan Commercial Bank Ltd., v. Hindustan General Electrical Corpn.,* (1960) 30 Com Cases 367 (Cal).

A case in which under the company's constitution preference shareholders were entitled to participate rateably with ordinary shareholders in surplus assets, it was held, on the facts that capitalisation of a reserve fund resulting from a revaluation of unrealised fixed assets for the benefit of ordinary shareholders did not encroach upon the rights of the preference shareholders to participate in "surplus assets" but had to be equated to payment of a dividend. *Dimbula Valley (Ceylon) Tea Co. Ltd. v. Laurie,* (1961) 1 All ER 769. A scheme of reduction of capital involving redemption of preference shares was not sanctioned because a scheme of that kind required the consent of the class of preference shareholders and the same had not been obtained. *Northern Engineering Industries Plc.,* 1993 BCLC 1151 (Ch D). **Affirmed** in Court of Appeal *Northern Engineering Industries Plc., Re,* (1994) 2 BCLC 704 (CA). See also *Campaign Holdings Pty Ltd. Re,* (1989) 15 ACLR 762 (Aust) where there were two relevant classes of shares, and the approval of a large majority of those in the less well treated class had been given, but on the basis of a misleading and incomplete disclosure. The case was referred to in *Ransomes Plc. Re,* (1999) 1 BCLC 775 (Ch D). **Affirmed** in *Ransomes plc. Re,* (1999) 2 BCLC 591 (CA) discussed in detail under section 100.

§ For a detailed Note on this subject refer to GORE-BROWNE ON COMPANIES 15-3-4 (Vol. I, 44th Edn.).

Reduction of reserves

If a company has created reserves out of retained profits and subsequently suffers a loss, it is normal practice to write off the loss against the reserves, and to reduce capital only if the reserves are insufficient to cover the loss. *Barrow Haematite Steel Co., Re,* (1900) 2 Ch 846 **affirmed** in (1901) 2 Ch 746 (CA). Where the assets were lost and the capital and reserves were employed as a mixed fund in carrying on the company's business, the loss should be attributed to each in proportion to its amount. *Hoare & Co., Re,* (1904) 2 Ch 208 (CA).

Conversion of shares of one class into another under scheme of arrangement *etc.*

In *Re St. James' Court Estates Ltd.,* 1944 Ch 6, the Court held that the conversion of irredeemable preference shares into redeemable preference shares could not be achieved through the medium of a scheme. It was held that the capital has to be reduced by cancellation of the irredeemable preference shares. This was on the principle that a scheme or arrangement is intended to achieve what can be done by a private arrangement between the company and its creditors and members and if some of the creditors or members do not agree, the court, by sanctioning a scheme, make it binding on the dissenting members or creditors. In PENNINGTON'S COMPANY LAW 5th Edn., 1985 it is stated at page 586 et seq. under the heading *'Limitation of Court's Powers'* as follows:—"The court cannot sanction a scheme which can be effected under some other provision of the Companies Act, 1948. Thus, the court refused to approve a scheme which merely provided for the reduction of company's capital and in the case cited above (*Re, St. James' Court Estates Ltd.,*) (*Supra*) where the court refused to approve the scheme for conversion of preference shares into redeemable preference shares, a second reason given for its decision was that the company could carry out the scheme by issuing new redeemable preference shares for cash and using the proceeds to pay off the existing preference shares on a duly authorised reduction of capital. But there seems to be no reason why a company should not seek the Court's sanction to a modification of shareholders' or de-

bentureholders' rights merely because there are provisions in its Article or in the Debenture Trust Deed by which the modification could be effected out of court." The Companies Act makes an express provision with regard to reduction of capital and that provision cannot be circumvented by obtaining an approval of the court to a scheme or arrangement under sections 391 to 394. On that account, conversion of equity shares or irredeemable preference shares into redeemable preference shares may be effected only through a process of reduction of capital.

In the case of *Re, Chowgule & Co. (P.) Ltd.,* 1972 Tax LR 2163, the Judicial Commissioner of Goa following the decision in the case of *St. James' Court Estates Ltd., (Supra)*, held that where the equity shares were sought to be converted into redeemable preference shares, it was necessary to adopt the process of reduction of capital under sections 100 to 104 of the Companies Act, 1956.

In a proposal for conversion of deferred shares into ordinary shares, a separate meeting of shareholders of each class for sanction was called as required by the articles. Other shareholders happened to be present at the meeting of the deferred shareholders. As to this the court said that this fact did not invalidate the meeting. The majority approval of the proposal was not vitiated by the fact that the reserves which had been wiped out and the future revenue bearing undertaking was not disclosed to the shareholders. The omission in question did not have the effect of bringing about any serious misapprehension of the position of the company. The court also said that the directors were not bound to disclose to the shareholders in the circular their own holdings or their interest in particular classes of shares. *Imperial Chemical Industries Ltd., Re,* (1938) 8 Com Cases 86 (CA). **Affirmed** by House of Lords in *Sub nom,* (1938) 8 Com Cases 181 : (1937) AC 707 (HL).

Purchase of own shares

Under section 77, no company limited by shares or limited by guarantee and having a share capital can buy its own shares, unless the consequent reduction of capital is sanctioned by the Court under sections 100 to 104 or section 402.

It is, however, not necessary that extinguishment of shares in all cases should necessarily result in reduction of share capital. Accordingly where reduction is not involved S. 100 would not be attracted. *Asian Investments Ltd., Re,* (1992) 73 Com Cases 517, 523 (Mad).

Buy back of shares [section 77A]

Section 77A inserted by the Companies (Amendment) Act, 1999, w.e.f. 31-10-1998 (being the date of enforcement of the ordinance which has been replaced by the Amendment Act, 1999) permits a company to buy-back its own shares or other specified securities in accordance with the prescribed procedure. The provisions of sections 100-105 have no applicability to the purchase of its own shares by a company in accordance with section 77A.

Qualification shares of directors

Where the directors are required to hold qualification shares, care must be taken that the effect of a reduction does not disqualify any director.

Reduction of capital by paying off and capital gains tax

Where a company reduces its share capital under section 100(1)(c) by paying off part of the share capital by reducing the face value of shares, such reduction amounts to extinguishment of the right of the member to the extent of reduction of face value of shares and therefore is a transfer under section 2(47) of the Indian Income-tax Act, 1961 and the amount received is liable to capital gains tax under section 45. *Kartikeya Sarabhai v. CIT,* (1982) Tax LR 1877. But see, *CIT v. G. Narasimhan,* (1979) 49 Com Cases 375 (Mad).

Modification in reference to Government Companies.—For the words "Court" wherever it occurs, the words 'Central Government' shall be substituted. *Notification GSR No. 238,* dated 2-2-1978.

Secretarial Practice Notes : Special resolution for reduction of share capital

Check whether during the year, the company had reduced its share capital? If so, check whether:

(i) the Article of the company authorised reduction of share capital?
(ii) a special resolution had been passed reducing share capital in terms of section 100(1)(a) to (c)?
(iii) the company had filed the petition in Form No. 18 along with Form No. 19 under the Companies (Court) Rules, 1959?
(iv) the company had complied with Rules 46 to 65 of the Companies (Court) Rules, 1959?
(v) the Court has confirmed the reduction of share capital?
(vi) the Court ordered to add words "and reduced" to its name, the same had been complied with?
(vii) order of the Court confirming the reduction of share capital had been produced to the Registrar?
(viii) the certified copies of the minutes as approved by the Court and the Court order had been filed with Registrar for registration?
(ix) the company has effected the change in memorandum and articles?

Documents Involved: 1. Memorandum and Articles, 2. Minutes of Board/General Meeting, 3. Forms 18 & 19 under the Companies (Court) Rules, 1959. Copy of the petition, 4. Court's Order (Form 30) under the Companies (Court) Rules, 1959, 5. Forms 31 & 32 under the Companies (Court) Rules, 1959, 6. List of Creditors in Form 21 under the Companies (Court) Rules, 1959, 7. Notice to Creditors, Form 23 under the Companies (Court) Rules, 1959, 8. Annual report, 9. Name board, Letter-head and Common Seal.

S. 101. Application to [5][*Tribunal*] for confirming order, objections by creditors, and settlement of list of objecting creditors.—(1) Where a company has passed a resolution for reducing share capital, it may apply, by petition, to the [5][*Tribunal*] for an order confirming the reduction.

(2) Where the proposed reduction of share capital involves either the diminution of liability in respect of unpaid share capital or the payment to any shareholder of any paid-up share capital, and in any other case if the [5][*Tribunal*] so directs, the following provisions shall have effect, subject to the provisions of sub-section (3) :—

(a) every creditor of the company who at the date fixed by the [5][*Tribunal*] is entitled to any debt or claim which, if that date were the commencement of the winding-up of the company, would be admissible in proof against the company, shall be entitled to object to the reduction ;

(b) the [5][*Tribunal*] shall settle a list of creditors so entitled to object, and for that purpose shall ascertain, as far as possible without requiring an application from any creditor, the names of those creditors and the nature and amount of their debts or

5. Subs. for the word 'Court' by the Companies (Second Amendment) Act, 2002 (11 of 2003), s. 14.

claims, and may publish notices fixing a day or days within which creditors not entered on the list are to claim to be so entered or are to be excluded from the right of objecting to the reduction;

(c) where a creditor entered on the list whose debt or claim is not discharged or has not determined does not consent to the reduction, the [6][*Tribunal*] may, if it thinks fit, dispense with the consent of that creditor, on the company securing payment of his debt or claim by appropriating, as the [6][*Tribunal*] may direct, the following amount—

(i) if the company admits the full amount of the debt or claim, or, though not admitting it, is willing to provide for it, then, the full amount of the debt or claim;

(ii) if the company does not admit and is not willing to provide for the full amount of the debt or claim, or if the amount is contingent or not ascertained, then, an amount fixed by the [6][*Tribunal*] after the like inquiry and adjudication as if the company were being wound-up by the [6][*Tribunal*].

(3) Where a proposed reduction of share capital involves either the diminution of any liability in respect of unpaid share capital or the payment to any shareholder of any paid-up share capital, the [6][*Tribunal*] may, if , having regard to any special circumstances of the case, it thinks proper so to do, direct that the provisions of sub-section (2) shall not apply as regards any class or any classes of creditors.

NOTES

Eng. Act, 1948 : Sec. 67
Eng. Act, 1985 : Sec. 136

Previous Act : Secs. 55 to 66

Note : As and when the Companies (Second Amendment) Act, 2002 (11 of 2003) comes into force, the power under this section shall become transferred to the Tribunal to be exercised by it in place of the High Court. The commentary should be read keeping this change in mind.

Companies (Second Amendment) Act, 2002 [11 of 2003]

The powers of Court under this section have been conferred on the Tribunal constituted under Part 1B of the Act. Consequential changes have accordingly been made in the section.

Proceedings for confirmation of reduction

The section prescribes the procedure of securing sanction of the court for reduction of capital and also enables the court to dispense with the prescribed procedure where it may be proper to do so. Accordingly, where the shareholders passed a resolution for converting preference shares with a dividend right to debentures with a higher interest, the court, after considering the fiscal health of the company, dispensed with the procedure for reduction of capital. *Investment Corporation of India Ltd., In Re,* (1987) 61 Com Cases 92 (Bom).

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6. Subs. for the word 'Court' by the Companies (Second Amendment) Act, 2002 (11 of 2003), s. 14.

An averment that the company is still carrying on business is not essential for the maintainability of a petition under this section. *Great Universal Stores Ltd., In re,* (1960) 1 All ER 252 : (1960) 30 Com Cases 339 (Ch D), **following** *British & American Trustee & Finance Corpn. v. Couper,* (1894) AC 399.

The petition should state the incorporation, registered office, objects and capital of the company and point out the provision in the articles which empowers the company to reduce capital, the reasons for reduction and the copy of the special resolution. It is not necessary to mention that the company is still carrying on the business *Re, Great Universal Stores Ltd.,* (1960) 1 All ER 252. Where there are more than one class of shares, which class has priority over the other as to capital should be stated. *Mackenzie & Co. Ltd.,* (1916) 2 Ch 450.

The petition should be supported by an affidavit. *Practice Direction,* (1966) 2 All ER 146. The certificate of registration, memorandum and articles of association and the current minute book of the company showing the proceeding of the meeting at which the resolution was passed must be exhibited. *Omnium Investment Co., Re,* (1895) 2 Ch 127. An affidavit is also required for averring that the meetings at which the special resolutions were passed was a valid meeting. A register of members must also be exhibited. *Uppingham Gas and Coke Co. Ltd.,* (1901) 45 Sol Jo 483.

The company's managing director, being an essential part of the proceedings, was not allowed to say that no remarks should have been passed against him. *Shri Ambica Mills Ltd., Re,* (1986) 59 Com Cases 368 (Guj).

Consent of creditors to reduction

Where the proposed reduction is by way of diminution of liability in respect of unpaid share capital or payment of any paid-up share capital to shareholders the creditors can object to the reduction. In other cases the creditors can object only with the consent of the court. The word creditor for this purpose means a person who has a debt or any claim against the company of such a nature as would have been provable in winding up. *Dicido Pier Co., Re,* (1891) 2 Ch 354; *Meux's Brewery Co. Ltd.,* (1919) 1 Ch 28; *Eastern & Australian S.S. Co. Ltd. & Reduced, Re,* (1893) 68 LT 321. This includes the company's lessors' and all other contingent or prospective creditors. *Re, Telegraph Construction Co.,* (1870) LR 10 EQ 384; *Re, The Palace Billiard Rooms Ltd. v. The City Property Investment Trust,* (1912) SC 5 (Scot), (the landlords claim for rent was ordered to be secured).

It has been held in an Australian case that where a company going in for reduction has subsidiaries, which are its creditors also and has obtained their consent by using its control power over them, the court should look at the matter with particular attention so as to protect the interests of the creditors of the individual subsidiaries. *Tolltreck Systems Ltd. (No. 2),* (1991) 4 ACSR 804 (Aust). The court has discretionary power in reference to a particular creditor or creditors generally to dispense with the consent of creditors.

Where in response to the creditors' objection to the proposed reduction, the company assured the court that their dues had been fully secured and also that the company had a sufficient amount in fixed deposit in the name of the Registrar Judicial to take care of any aggrieved creditor, the court confirmed the resolution for reduction in terms of the minutes of the meeting of shareholders. The court also approved the necessary alteration of the memorandum. *OCL India Ltd. Re,* (1998) 4 Comp LJ 441 : (1999) 32 CLA 250 (Ori).

Where a person was entitled to get *mesne* profits from the company and the same would have become a debt only when a decree was passed by the court and this had not happened when the company applied for confirmation of the court, it was held that he was not a creditor yet. He was neither entitled to a notice nor to be heard. *Shapoorji Data Processing Ltd. v. Ameer Trading Corpn. Ltd.,* (2003) 43 SCL 486 (Bom).

Power to dispense with procedure under sub-s. (2) [Sub-section (3)]

This sub-section gives effect to the Company Law Committee *Report* (Para. 51):— "Sections 58 and 59 of the Indian Companies Act, 1913, require that where the proposed reduction of share capital involves either diminution of liability in respect of unpaid share capital or the payment to any shareholder of any paid-up share capital, the Court shall settle the list of creditors entitled to object to the reduction and adjudicate on their claims to object before it passes any order confirming the reduction. It is not open to the Court to dispense with this elaborate procedure, even if it is satisfied that no such adjudication is necessary. We recommend that this apparent limitation on the power of the Court should be removed by the incorporation in section 59 of a sub-section similar to sub-section (3) of section 67 of the English Companies Act, 1948. This sub-section enables the Court to dispense with the formalities relating to the settlement of creditors' objections, where it is satisfied that the scheme of reduction would not jeopardise their interest. This would be particularly useful where life insurance offices desire to reduce their capital as, under the existing law, Courts have no power, even in fit cases, to dispense with notice to policy-holders who are reconsidered to be creditors of such companies".

A company presented a scheme for cancellation of equity shares held in small lots and to issue in lieu thereof 11 per cent secured redeemable non-convertible debentures to curtail unnecessary costs and ensure easy payment to investors. An over-whelming majority of the equity sahreholders voted in favour of the scheme. An order was passed in which the Court dispensed with compliance of the provisions of s. 101(2). The order was rectified because of some error. The company was required to give individual notices only to those whose claim exceeded Rs. 1,00,000. The notices to individual creditors merely permitted them to object to the scheme in general. The court said that the settlement of the objections of creditors and securing their interest does not require a full-fledged trial of their claims, or any payment to them. A study of the financial state of the company is necessary before passing orders under the section. *Hindustan Dorr Oliver Ltd. Re,* (2002) 40 SCL 521 (Bom).

When a company proposes to reduce its share capital or utilise its share premium account for the purpose of writing off loss and other permissible adjustments, it can make an application for dispensing the requirement of settlement of list of creditors. It is also advisable that where there is a proposed reduction of share capital or adjustment of share premium account, it is advisable to get consent letters from all the creditors for dispensing with the cumbersome requirement of directing notice to all the creditors and settling the list thereof.

Reduction of Securities Premium Account

§ For comments on this topic see Notes under section 78 *ante* under the same heading.

Arrangement, amalgamation and reduction of capital

Section 391 is a complete code by itself. Once a scheme of compromise and arrangement falls squarely within the four corners of the section, it can be sanctioned, even if it involves doing acts (including reduction of capital) for which the procedure is specified in other sections of the Act. Where it is intended that particular effect cannot be achieved except by following the procedure laid down, a specific provision is enacted to that effect, for example, Rule 85 of the Companies (Court) Rules, 1959 which provides that the reduction of share capital must be done in the manner set out in S. 100 *et. seq. Re, Maneckchowk and Ahmedabad Mfg. Co. Ltd.,* (1970) 40 Com Cases 819 (Guj) **followed** in *Re, Navjivan Mills Ltd., Kolol* (1972) 42 Com Cases 265 (Guj); *Hindustan Commercial Bank Ltd. v. Hindustan General Electrical Corpn.,* (1960) 30 Com Cases 367 : AIR 1960 Cal 637. Where the reduction of capital is a part of a scheme of arrangement the requirements of the Companies Act as regards reduction of capital are not applicable because court can sanction reduction as a part of the scheme. *Cooper, Cooper and Jhonson Ltd., Re,* (1902) WN 199; *Stephan Watters & Sons Ltd.,* (1926) WN 236; *Durairajan (T.) v. Waterfall Estates Ltd.,* (1972) 42 Com Cases 563 (Mad) **followed in** *Asian Investments Ltd., Re,* (1992) 73 Com Cases 517, 523 (Mad).

The word 'arrangement' is given an inclusive definition and contemplates not merely reorganisation of share capital but even a modification of the rights of shareholders.

Investment Corporation of India Ltd., In Re, (1987) 61 Com Cases 92 (Bom).

Where under an arrangement the company itself is dissolved without being wound up, there is no reduction as contemplated by the Companies Act. *Durai Rajan (T.) v. Waterfall Estates Ltd., (Supra).* In this case the VEERASWAMI CJ and RAGHAVAN J summarised the position of law very clearly in the following terms [(1972) 42 Com Cases 563 at 567]: "The object of asking for confirmation by court of reduction of capital is to safeguard the interests of the creditors of the company, and other obligations or rights coming into existence in the light, or on the strength of existing capital structure either fully paid-up, or realisable at call. The scheme, in the instant case, involves transfer of the entire assets, rights and liabilities of the amalgamating companies to the new company which becomes, when the scheme takes effect, liable to the creditors of the amalgamating companies to the fullest extent. To such a case the procedure for reduction of share capital, as provided for by sections 100, 101 and 102 is hardly applicable. Rule 85, in our opinion, does not contemplate a compromise or arrangement in the nature of a scheme of amalgamation, such as we have here." The learned judges further observed as follows at page 568: "The context of the decision makes it inapplicable to the facts before us. It is not every extinguishment of shares, as we are inclined to think, that is reduction in capital, unless the company continues to exist. Where by the process of arrangement the company itself is dissolved without winding up, it is hardly a case of reduction in capital as contemplated by the provisions of the Companies Act, 1956. If the object of these provisions is to safeguard creditors who may rely on the capital structure and take a step in advancing money, or concluding other transactions in the company, the scheme in the instant case does not, in any way, defeat or affect it, for, the interests of the creditors have been fully safeguarded by the terms of the proposed amalgamation."

In *Asian Investments Ltd., Re,* (1992) 73 Com Cases 517, 523 (Mad) LAKSHMANAN J. **following** these principles explained (at p. 523) interaction of provisions as to reduction of capital with those as to amalgamation. He said: Section 77 imposes a restriction on purchase by a company of its own shares. It is not necessary that extinguishment of shares in all cases should necessarily result in reduction of share capital. Section 100 will not come into play where the scheme of amalgamation contemplates the transfer of the entirety of assets and liabilities of the transferor-company to the transferee-company. In such a case, in my view, there is no release of assets. The assets of the transferor-company, on amalgamation, stand transferred to and vested in the transferee-company.

Where all the creditors were paid off and a surplus remained in the hands of the liquidator even after both preference and equity shareholders were paid, a scheme by the equity shareholders to revive the company with the surplus money, was held not to attract Section 101 because there was no reduction of capital. *Mcleod & Co. v. S.K. Ganguly,* (1975) 45 Com Cases 563 (Cal—DB).

Where reduction of capital was necessary for implementing a scheme of amalgamation because a part of the capital was lost and was unrepresented by available assets and compliance with statutory requirements for reduction, such as notice to shareholders, was substantially made, the court simultaneously passed an order approving the scheme and reduction and did not consider it necessary that the words "and reduced" should be added to the name of the company. *Novopan India Ltd., Re,* (1997) 88 Com Cases 596 (AP). Another case in which reduction of capital became necessary, the court said that basic requirements, such as special resolution for reduction, were mandatory but the requirement of setting out the intention to move a resolution as a special resolution could not be said to be mandatory. *Sumitra Pharmaceuticals and Chemicals Ltd., Re,* (1997) 88 Com Cases 619 (AP).

Before approving a scheme for the reduction in the share capital of a company the court has to be satisfied that all material changes of circumstances between the announcement of the proposed scheme and the meeting to approve it were made known to persons entitled to vote. It was held, approving the scheme, that although company's articles of association did not allow the reduction of its share capital below £50,000, the provision would be given a purposive construction to permit a reduction below that level which was for an instant of time prior to the creation of the new shares in the company *MB Group Ltd., Re,* 1989 BCLC 672. If, by a reduction of capital, a public company re-

duces its issued share capital to less than £50,000, but immediately increases it to more than £50,000 by a resolution which takes effect before or at the same as the reduction resolution, there is no obligation to re-register the company as a private one. (*ibid*)

A scheme involving reduction of capital was presented for sanction of the court. The issued share capital of the company consisted of some B shares and some ordinary shares. The scheme was designed to effect a merger. The other company was to acquire all the issued ordinary shares. Such shares were to be cancelled and their holders were to be allotted shares in the acquiring company. At a meeting of such shareholders 96.9% voted in favour of the scheme and only 3.1% voted against. The court restated the functions of the court in this connection and said that it was not inappropriate to have a single class of scheme shares. Whether or not a separate class meeting needs to be held depends on whether the shares had different rights attached to them. This was not the case here and, therefore, there was no need for separate class meetings. *BTR plc Re,* (1999) 2 BCLC 675 (Ch D). An appeal against the decision was **refused** in *BTR plc. Re,* (2000) 1 BCLC 740 (CA).

Where all the formalities for reduction of capital in a scheme of arrangement were complied with and approved by requisite majorities but the main participant to whom the company's business was to be disposed off backed out and the company made an arrangement with an alternative buyer, the court approved the scheme with the alternative buyer because substitution of the buyer was not capable of causing any prejudice to the members and creditors who had approved the scheme. *Allied Domecq plc Re,* (2000) 1 BCLC 134 (Ch D).

Listing Agreements requirements

For compliance of clause 24 of Listing Agreement by Listed Companies, refer to Notes under section 391, *post.*

Practical steps in procedure for reduction

§ For a detailed account of the successive steps for implementing the decision to reduce share capital, refer procedure notes under s. 100.

Prescribed Form.—For Form of application to Court and Procedure, see Companies (Court) Rules 46 to 65 in *Appendix* 4.

Modification in reference to Government Companies.—"For the word 'Court' wherever it occurs, the words 'Central Government' shall be substituted." *Notification* GSR No. 238, dated 2-2-1978.

Secretarial Practice Notes

§ See Practice Notes under section 100.

S. 102. Order confirming reduction and powers of [7][*Tribunal*] on making such order.—(1) The [7][*Tribunal*], if satisfied with respect to every creditor of the company, who under section 101 is entitled to object to the reduction, that either his consent to the reduction has been obtained or his debt or claim has been discharged, or has determined or has been secured, may make an order confirming the reduction on such terms and conditions as it thinks fit.

(2) Where the [7][*Tribunal*] makes any such order, it may—

(a) if for any special reason it thinks proper so to do, make an order directing that the company shall, during such period commencing on, or at any time after, the date of the order, as

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7. Subs. for the word 'Court' by the Companies (Second Amendment) Act, 2002 (11 of 2003), s. 14.

is specified in the order, add to its name as the last words thereof the words "and reduced"; and

(b) make an order requiring the company to publish, as the [7a][*Tribunal*] directs the reasons for reduction or such other information in regard thereto as the [7a][*Tribunal*] may think expedient with a view to giving proper information to the public, and, if the [7a][*Tribunal*] thinks fit, the causes which led to the reduction.

(3) Where a company is ordered to add to its name the words "and reduced", those words shall, until the expiration of the period specified in the order, be deemed to be part of the name of the Company.

NOTES

Eng. Act, 1948 : Sec. 68
Eng. Act, 1985 : Sec. 137

Previous Act : Secs. 57, 60, 65

Note : As and when the Companies (Second Amendment) Act, 2002 (11 of 2003) comes into force, the power under this section shall become transferred to the Tribunal to be exercised by it in place of the High Court. The commentary should be read keeping this change in mind.

Companies (Second Amendment) Act, 2002 [11 of 2003]

The powers of Court under this section have been conferred on the Tribunal constituted under Part 1B of the Act. Consequential changes have accordingly been made in the section.

Court's discretion and order of confirmation of reduction

The court has first to be satisfied that the creditors who had objected to the reduction that either their consent to the reduction has been obtained or their debts or claims have been discharged or settled or secured. The court has the power to dispense with this procedure if there is strong cause. Thus in *Re, Meux's Brewery Co. Ltd.*, (1919) 1 Ch 28, debenture-holders unsuccessfully objected that the proposed reduction would be prejudicial to their security by enabling the company to pay dividends out of profits instead of such profits being applied in making good the lost capital. No evidence was adduced, however, to show what part of the lost capital was attributable to circulating capital. The court can also correct immaterial errors in the resolution. *Willaire Systems plc.*, 1987 BCLC 67.

The court's power in the matter is discretionary and conditions may be imposed. *British and American Trustee and Finance Corpn. v. Couper*, (1894) AC 399 (HL); *Re, Fore-Street Warehouse Co. Ltd.*, (1888) 59 LT 214; *Re, Watson, Walker and Quickfall Ltd.*, (1898) WN 69; *Re, Thomas De la Rue & Co. Ltd. and Reduced*, (1911) 2 Ch 361; and *Cf. Poole v. National Bank of China Ltd.*, (1907) AC 229 at 240 (HL). See *Re, Jupiter House Investments (Cambridge) Ltd.*, 1985 BCLC 222 and *Re, Grosvenor Press plc.*, 1985 BCLC 286 (possibility of capital being recovered; undertakings to protect creditors).

The court may require an alteration in the structure of voting powers. *Re, Newbery-Vautin (Patents) Gold Extraction Co. Ltd.*, (1892) 3 Ch 127n; *Re, Pinkney & Sons SS Co.*, (1892) 3 Ch 125 or evidence of the company's financial position. *Safety Oil Co. Ltd.*, (1892) 36 Sol Jo 699 or that there are no fresh creditors (*ibid*); *Watson, Walker and Quickfall Ltd.*, (1898) WN 69 or it may require money to be set aside for paying future rents. *Telegraph Construction Co., Re*, (1870) LR 10 Eq 384.

7a. Subs. for the word 'Court' by the Companies (Second Amendment) Act, 2002 (11 of 2003), s. 14.

The courts generally require companies to use the words "and reduced" as a part of their name for such time as the court may order and to publish in newspapers for the sake of public knowledge of the reasons for the reduction. *Re, Llynvi, Tondu and Ogmore Coal and Iron Co.*, (1877) 37 LT 373; *Re, Truman Hanbury, Buxton & Co. Ltd.*, (1910) 2 Ch 498; *Ebbw, Vale Steel Iron and Coal Co., Re*, (1877) 4 Ch D 827.

§ For further Notes see under s. 100 under the heading "Manner of effecting reduction of share capital and discretion of court."

Duty and powers of court

"What then is the duty of the Court in considering a matter of this kind? In the *first* place, the interests of creditors must be safeguarded, but, here that has been done. *Secondly*, the interests of shareholders may have to be considered but in this case there has been no opposition by any shareholder at any time and it is difficult to see how there could be any prejudice to any single shareholder. *Thirdly*, there is the public interest to consider. That this is a relevant consideration was clearly recognised by LORD MACNAGHTEN in *Poole v. National Bank of China Ltd.*, 1907 AC 229. It would not be disposed to define "public interest" to narrow in any way the discretion of the Court in any future case, but in a case like the present I think that it is right to scrutinise the facts somewhat closely having in mind the position of those who may in future form connections with the company as creditors or shareholders.

"Matters like the possibility of nationalisation and the ulterior object of a company to defeat future legislation may be good ground for scrutinising whether the existing law is complied with in every respect.

"Further, the extent and amount of reduction are domestic matters and so long as there is no injustice to the creditors or shareholders, the Court is not concerned with the precise amount of reduction of capital," *Westburn Sugar Refineries Ltd.*, (1951) 1 All ER 881.

Special circumstances which would justify a direction for dispensing with creditors' objections must be such as would satisfy the court that so far as could be reasonably foreseen the relevant creditors would not be adversely affected by the proposed reduction. But if the creditors actually appear and object, the court would dispense with a creditor's assent only if the company secured payment of his claim by appropriating a sufficient sum. *Re, Lucania Temperance Billiard Halls (London) Ltd.*, (1965) 3 All ER 879 : (1966) 1 Comp LJ 350 (Ch D). "The power under this section is conferred on the court in order to enable it to protect the interests of dissenting shareholders and even those who do not appear. Before confirming a reduction the court must see that the interests of the minority shareholders and of the creditors are adequately protected and that there is no unfairness even though this is an internal matter of the company." *Indian National Press (Indore) Ltd., In re*, (1989) 66 Com Cases 387 (MP).

Where a scheme of reduction was adopted by a bank with *mala fide* motives in order only to nullify the protection granted to displaced persons by the Displaced Persons (Debts Adjustment) Act, 1951, it was held that the court could order the company to convert the partly paid shares into fully paid shares as envisaged by the statutory provision. *Oriental Bank of Commerce Ltd. v. Harcharan Das Loomba*, (1963) 33 Com Cases 791 : AIR 1963 SC 1707.

When the reduction is consequent on a change in the method of carrying on the company's business, it is for the shareholders to decide to what extent its capital is in excess of its wants and on the adequacy of the consideration for the reduction of their share capital but the powers of the shareholders must be exercised so as to safeguard the right of creditors, the just and equitable treatment of shareholders and the interests of the investing public. These principles were **affirmed** in *British and American Trustee and Finance Corporation v. Couper*, 1894 AC 399; *Poole v. National Bank of China Ltd.*, 1907 AC 229; *Caldwell & Co. Ltd. v. Caldwell*, 1916 SC 120 (HL); *Re, De La Rue (Thomas) and Co. Ltd. and Reduced*, (1911) 2 Ch 361. In the case of reduction of capital the task of

the Court is not only to see that the procedure by which the reduction is carried through is formally correct and that the creditors are not prejudiced but it has the further duty of satisfying itself that the scheme is fair and equitable between the different classes of shareholders. As to what is fair and equitable must depend on the circumstances of each case. *Scottish Insurance Corporation v. Wilsons & Clyde Coal Co. Ltd.*, (1949) 1 All ER 1068 : (1949) 19 Com Cases 202 (HL).

Neither the transfer of the undertaking of a company to another company nor the disappearance of assets for any cause is a reduction of capital. *Shyampada Chakrabertty v. Controller of Insurance*, AIR 1962 SC 1355 : (1962) 32 Com Cases 258. A scheme of amalgamation involving transfer of the entire assets, rights and liabilities of the amalgamating companies to the new company which will pay off the preference shares of the amalgamating companies, does not attract the provisions of Sections 100, 101 and 102, *Durai Rajan (T.) v. Waterfall Estates Ltd.*, (1972) 42 Com Cases 563 at 567 (Mad) **followed** in *Asian Investments Ltd., Re*, (1992) 73 Com Cases 517 (Mad).

Modification in reference to Government Companies.—"For the word 'Court' wherever it occurs, the words "Central Government" shall be substituted. *Notification* GSR No. 238, dated 2-2-1978.

Secretarial Practice Notes: § See Secretarial Practice Notes under section 100.

S. 103. Registration of order and minute of reduction.—(1) The Registrar—

(a) on production to him of an order of the [8][*Tribunal*] confirming the reduction of the share capital of a company; and

(b) on the delivery to him of a certified copy of the order and of a minute approved by the [8][*Tribunal*] showing, with respect to the share capital of the company as altered by the order, (i) the amount of the share capital, (ii) the number of shares into which it is to be divided, (iii) the amount of each share, and (iv) the amount, if any, at the date of the registration deemed to be paid up on each share;

shall register the order and minute.

(2) On the registration of the order and minute, and not before, the resolution for reducing share capital as confirmed by the order shall take effect.

(3) Notice of the registration shall be published in such manner as the [8][*Tribunal*] may direct.

(4) The Registrar shall certify under his hand the registration of the order and minute, and his certificate shall be conclusive evidence that all the requirements of this Act with respect to reduction of share capital have been complied with, and that the share capital of the company is such as is stated in the minute.

(5) The minute when registered shall be deemed to be substituted for the corresponding part of the memorandum of the company, and shall be valid and alterable as if it had been originally contained therein.

(6) The substitution of any such minute as aforesaid for part of the memorandum of the company shall be deemed to be an alteration of the memorandum within the meaning and for the purposes of section 40.

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8. Subs. for the word 'Court' by the Companies (Second Amendment) Act, 2002 (11 of 2003), s. 14.

NOTES

Eng. Act, 1948 : Sec. 69
Eng. Act, 1985 : Sec. 138

Previous Act : Secs. 55 to 66

Note : As and when the Companies (Second Amendment) Act, 2002 (11 of 2003) comes into force, the power under this section shall become transferred to the Tribunal to be exercised by it in place of the High Court. The commentary should be read keeping this change in mind.

Companies (Second Amendment) Act, 2002 [11 of 2003]

The powers of Court under this section have been conferred on the Tribunal constituted under Part 1B of the Act. Consequential changes have accordingly been made in the section.

Court's minute and certificate

In making its order the court approves a minute. Embodying the minute in a confirmatory order is a sufficient approval. *Sharp, Stewart & Co., Re,* (1867) LR 5 Eq. 155, 159. The minute is designed to show the altered structure of the company's capital the amount of the remaining share capital, the number of shares into which it is to be divided, the amount of each share and the amount, if any, at the date of the registration of the minute deemed to be paid-up on each share.

Where the court approved reduction of capital for the purpose of converting the capital so reduced into equivalent amount in US Dollars, the court ordered that the minute should show that immediately after the reduction of the company's capital that the company's capital was increased by an amount which in dollars was equivalent to the £50m by which the company's capital had been reduced. *Re, Anglo American Insurance Co Ltd.,* 1991 BCLC 564 (Ch D).

This minute, together with a copy of the order, has to be delivered to the Registrar, who registers it and gives a certificate under his hand or authenticated by his seal. The date of filing of the return with the Registrar of Companies is the effective date of reduction of share capital. *CIT v. Industrial Credit & Dev. Syndicate Ltd.,* (1989) 3 Comp LJ 266, 268 (Kar); *Castiglione Erskine & Co. Ltd.,* (1958) 2 All ER 455.

Notice of registration must be published in such manner as the court directs. Under English Law, publication of notice of registration cannot be dispensed with. *West African Telegraph Co. Ltd., Re,* (1886) 55 LJ Ch 436. See the Company Court Rules, Rule 65. Only notice of the fact of the registration has to be advertised and not the whole minute. *North Pole Ice Co. Ltd. and Reduced, Re,* (1924) WN 131; *Oceana Development Co. Ltd., Re,* (1912) 56 Sol Jo 537.

A minute confirmed by the court pursuant to this section should not refer to any writing down, or writing off, of the Share Premium Account, since: (a) the reference is irrelevant if the account is written off; and (b) if it is written down, the substitution of the minute in the company's memorandum would result in a conflict between Sections 16(1) and 78(2) of the Act (English). *Paringa Mining and Exploration Co. Ltd., Re,* (1957) 3 All ER 424 : (1958) 28 Com Cases 252 (Ch D).

Conclusiveness of certificate

Where after due confirmation the reduction was registered with the Registrar and he issued his certificate, the same was held to be conclusive although it was afterwards discovered that the company had no authority under its articles to reduce capital. *Re, Walkar & Smith Ltd.,* (1903) 88 LT 792 (Ch D). Similarly the reduction was not allowed to be upset merely because the special resolution for reduction was invalid. *Ladies' Dress Assn. v. Pulbrook,* (1900) 2 QB 376. The minute is conclusive of the capital of the company from the date of its registration.

Prescribed Form: The order of the Court confirming reduction along with the minutes approved by the Court may be filed with the Registrar along with Form No. 32 as set out in *Appendix* 4.

Relevant Rule.—The Company (Court) Rules R. 65, Form No. 32 (*Appendix* 4).

Modification in application to Government Companies.—"For the word 'court' wherever it occurs the words 'Central Government' shall be substituted." *Notification No.* 238, dated 2-2-1978.

Secretarial Practice Notes: § See Secretarial Practice Notes under section 100.

S. 104. Liability of members in respect of reduced shares.—(1) A member of the company, past or present, shall not be liable, in respect of any share, to any call or contribution exceeding in amount the difference, if any, between the amount paid on the share, or the reduced amount, if any, which is to be deemed to have been paid thereon, as the case may be, and the amount of the share as fixed by the minute of reduction :

Provided that, if any creditor entitled in respect of any debt or claim to object to the reduction of share capital is, by reason of his ignorance of the proceedings for reduction or of their nature and effect with respect to his debt or claim, not entered on the list of creditors, and after the reduction the company is unable, within the meaning of section 434, to pay the amount of his debt or claim, then—

(a) every person who was a member of the company at the date of the registration of the order for reduction and minute, shall be liable to contribute for the payment of that debt or claim an amount not exceeding the amount which he would have been liable to contribute, if the company had commenced to be wound-up on the day immediately before the said date; and

(b) if the company is wound-up, the [9][*Tribunal*] on the application of any such creditor and proof of his ignorance as aforesaid, may, if it thinks fit, settle accordingly a list of persons so liable to contribute, and make and enforce calls and orders on the contributories settled on the list, as if they were ordinary contributories in a winding-up.

(2) Nothing in this section shall affect the rights of the contributories among themselves.

NOTES

Eng. Act, 1948 : Secs. 70 and 71
Eng. Act, 1985 : Secs. 140 and 141

Previous Act : Sec. 63

Note : As and when the Companies (Second Amendment) Act, 2002 (11 of 2003) comes into force, the power under this section shall become transferred to the Tribunal to be exercised by it in place of the High Court. The commentary should be read keeping this change in mind.

Companies (Second Amendment) Act, 2002 [11 of 2003]

The powers of Court under this section have been conferred on the Tribunal constituted under Part 1B of the Act. Consequential changes have accordingly been made in the section. Notes on Clauses of the Bill stated thus:

Notes on Clause.—This clause seeks to amend section 104 of the Companies Act, 1956. The existing provisions contained in the section deal with liability of Members in respect of reduced shares. The provisions contained in the said section confer power upon

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9. Subs. for "the Court" by the Companies (Second Amendment) Act, 2002 (11 of 2003), s. 14.

the Court to settle the list of persons liable to contribute and enforce the calls in the winding up of a company. It is proposed to confer this power upon the Tribunal. This amendment is of consequential nature. (*Clause* 13 of the Companies (Amendment) Bill, 2001).

Settling the list of contributories [Sub-section (1)(b)]

As regards settling the list of contributories under this clause, see Rule 196 of the Companies (Court) Rules in *Appendix* 4.

Modification in regard to Government Companies

For the word "court" wherever it occurs the words "Central Government" shall be substituted. *Notification No.* 238, dated 2-2-1978.

Secretarial Practice Notes: § See Secretarial Practice Notes under section 100.

S. 105. Penalty for concealing name of creditor, *etc.*—If any officer of the company—

(a) knowingly conceals the name of any creditor entitled to object to the reduction;

(b) knowingly misrepresents the nature or amount of the debt or claim of any creditor; or

(c) abets or is privy to any such concealment or misrepresentation as aforesaid;

he shall be punishable with imprisonment for a term which may extend to one year, or with fine, or with both.

NOTES

Eng. Act, 1948 : Sec. 71 Previous Act : Sec. 64
Eng. Act, 1985 : Sec. 141

Penalty for default

Mens rea is necessary ingredient to constitute the offence.

Compoundable offence.—The offence is compoundable under section 621A.

Secretarial Practice Notes : § See Secretarial Practice Notes under section 100.

Variation of shareholders' rights

†**[S. 106. Alteration of rights of holders of special classes of shares.—**Where the share capital of a company is divided into different classes of shares, the rights attached to the shares of any class may be varied with the consent in writing of the holders of not less than three-fourths of the issued shares of that class or with the sanction of a special resolution passed at a separate meeting of the holders of the issued shares of that class—

(a) if provision with respect to such variation is contained in the memorandum or articles of the company, or

(b) in the absence of any such provision in the memorandum or articles, if such variation is not prohibited by the terms of issue of the shares of that class.]

† Subs. by Companies (Amendment) Act (65 of 1960), s. 26.

NOTES

Eng. Act, 1948 : Sec. 72
Eng. Act, 1985 : Sec. 127

Previous Act : Sec. 66-A & Regulation 4 of Table A of Schedule I.

Companies (Amendment) Act, 1960

The section has been amended in conformity with the following recommendation of the Companies Act Amendment Committee:—

Majority needed for alteration of class rights.—"As the section stands, an absolute majority of 3/4ths of all the shareholders of the class affected is required. In view of the fact that a remedy is given to the dissentient shareholders by an application to the Court under section 107 there need not be an insistence of an absolute majority of 3/4ths of the shareholders belonging to the class. The provision of section 106(1) and (2) are in any case inconsistent with Regulation 3(1) of Table 'A' in Schedule I, which provides that the rights attached to any class of shares may be varied with the sanction of a special resolution passed at a separate general meeting of the holders of the shares of that class. We recommend that Regulation 3(1) of Table 'A' may be substituted for section 106(1) and (2) with some amendments". (*Report*: para 52).

Notices & Quorum.—The provisions of sections 171 to 186 as regards notices and quorum will apply to class meetings also as provided in section 170.

What constitutes a class right

The articles may omit to assign, expressly, shares with differing rights to different classes, but for the purposes of articles about variations of class rights and for the purpose of Ss. 106-107 those shares may still belong to different classes. This appears from *Crumpton v. Morrine Hall Pty. Ltd.*, (1965) NSWR 240 (Australia) in which the shares of a home-unit company without express reference to classes were divided into groups and the holding of a group of shares entitled the holder to the use of a particular home unit identified with that group and no other. In that case the right to a particular unit which attached to one group differed from the right attached to another group. *Cf. Bushell v. Faith*, (1970) AC 1099 : (1970) 40 Com Cases 944 (HL). Thus it is not necessary to constitute a class that special rights should be attached to any particular shares. They may be conferred on the person concerned in his capacity as a member or shareholder of the company and for the purposes of this section they will also be regarded as rights attached to a class of shares. *Cumbrian Newspapers Group Ltd. v. Cumberland & Westmoreland Herald Newspapers & Printing Co. Ltd.*, (1986) 2 All ER 816 *e.g.* (in this case a right of pre-emption on a takeover offer.) It is submitted in PALMER'S COMPANY LAW, that this is a mistaken analysis and that to constitute a class of shares the special rights must attach to the specific shares and not the particular holder. See at pp. 525 and 538, (PALMER'S COMPANY LAW, 24th Edn. 1987: Paras 6.007 and 6.029, 25th Edn., 1992).

How class rights are created

Special class rights may be created by the terms of issue or by a special resolution. In these cases they are treated in the same manner as those defined in the articles, *e.g.*, in *Old Silk Stone Collieries Ltd., Re*, (1954) 1 All ER 68, where the assets of a colliery were acquired and the company was to be wound up, a resolution at the general meeting to give to the preference shareholders the right to adjustment in respect of the compensation money was taken to have become a class right preventing its abrogation merely by passing another resolution at a subsequent meeting. Special class rights generally relate to dividend, voting or the distribution of assets in the winding up of the company.

Special rights may also be provided for in the memorandum or in the articles or in a separate agreement between the company and the special class. Whenever therefore the question of variation of special rights arises it is necessary to see first whether as to where those rights are defined. Definition of special rights in the memorandum may give the members of that class a higher degree of protection than their definition in the articles. If

the definition of special rights is not clear and is creating problem of interpretation, a scheme of arrangement may be drawn to clarify them. *Edinburgh Rly. Co. v. Scottish Metropolitan Assurance Co.*, 1932 SLT 49 (Scotland). In such cases the memorandum may itself provide a variation procedure or it may prohibit any variation or it may be silent on the matter.

If the rights are defined in the articles, the procedure of alteration is also generally specified in the articles and the usual procedure is an extraordinary resolution at a meeting of the shareholders of that class. Such a meeting must be called and conducted in the same manner as any other general meeting of the Company. If the articles do not provide any procedure for alteration, nor there is any prohibition on alteration then the procedure of Ss. 106 and 107 becomes available. If these two sections are not available because of the prohibition on variation then either a scheme of arrangement or of reduction of capital, in both cases with the sanction of the court, is the only alternative.

Variation of Class rights

The variation referred to is variation to the prejudice of any class of shareholders, and not any variation adding to or enhancing rights of any class. It is only where a variation involves the curtailment of the rights of any class or classes of shareholders, the consent or sanction of such class or classes will be necessary.

A power to vary class rights has been held in Scotland not to include a power to extinguish such rights—*Gill v. Arizona Copper Co.*, (1901) 2F (Ct. of Sess.) 843. Although Section 125(8) of English Companies Act, 1985 provides that, as a general rule, variation includes abrogation of class rights, this does not apply where the context requires otherwise. PALMER'S COMPANY LAW, 24th Edn., 34-26, page 538.

The term "variation" has been defined in section 2(50) of the Companies Act, 1956 to include abrogation. This meaning cannot be imported in section 106, in the context in which it is used therein.

A variation which merely affects the enjoyment of a right without modifying the right itself does not come within the section. *In re, Hindustan General Electric Corporation*, (1959) 29 Com Cases 144 : AIR 1959 Cal 679.

A cancellation of preference shares by repayment of the capital paid upon those shares and in accordance with the rights attached to those shares does not involve a variation of the rights of any other shareholders of the company. *Re, Saltdean Estate Co. Ltd.*, (1968) 3 All ER 829 (Ch D) : (1969) 39 Com Cases 386; *House of Fraser v. ACGE Investments Ltd.*, 1987 BCLC 478 (HL). It also does not involve any modification or variation of class rights so as to require a meeting of the preference shareholders. *ACGE Investments Ltd. v. House of Fraser*, (1987) LRC (Comm) 844 (HL). Though their Lordships **affirmed** the decision of BUCKLEY J in the *Saltdean Estates case* but LORD KEITH added a rider to the effect that the rule that variation does not include extinction would apply unless the reduction can be shown to be unfair to the preference shareholders on other grounds. Consequently, the principle applied by LORD KEITH does not exclude the application of S. 459 of the 1985 Act (corresponding to section 397) which protects shareholders against unfair prejudicial treatment. Thus if preference shareholders can show that the time chosen by the company to pay them back is capable of causing unfair prejudice the court may prevent such reduction or permit reduction subject to such protective conditions. For comments see, the Editorial at page 165, 1987 JBL (UK). Shares carrying special rights as to voting may, it is submitted, be similarly cancelled without reference to the variation rules. Cancellation is not a variation in the technical sense. Class rights may be varied as part of a reduction of capital. *Saltdean Estate Co. Ltd., Re, (Supra)*; *House of Fraser plc. v. ACGE Investments Ltd., (Supra)*; *Belmenach-Glenlivet Distillery v. Croall*, 14 SLT 261 (Scotland).

Increasing the capital of a company does not amount to varying class rights. The promise of a company to its foreign collaborator that he would be entitled to 26% of the

company's equity was held to be not breached when the company resolved in accordance with its articles and in compliance with s. 81(1A) to capitalise the interest due to the Financial Institutions in respect of their loans and to issue them in lieu thereof equity shares in the company. The Bombay High Court refused to stay the implementation of the issue. Twenty-six per cent of the equity held by a shareholder does not make him a class by itself unless he has some special rights attached to his holding. *Spindel Fabrik Suessen v. Suessen Textile Bearing Ltd.*, (1989) 2 Corpt LA 202 (Bom).

In a *bona fide* exercise of the right by following the due procedure and within limits of the authority the conversion of loans of an ex-director into shares does not violate the provisions of s. 106 relating to variation of class rights even if voting power of other shareholders would be affected. But because the company was under rehabilitation scheme before the BIFR under the Sick Industrial Companies (Special Provisions) Act, 1985 and because such a scheme of conversion would deprive the company of what belonged to it, the conversion would be violative of the SICA unless approved by the BIFR. *Girish Kumar Kharia v. Industrial Forge & Engg. Co. Ltd.*, (1999) 21 SCL 234 : (1999) 35 CLA 364 : (2000) CLC 105 (Pat).

Strengthening the position of the ordinary shareholders as compared with the preference shareholders by issuing further shares to them and increasing their voting power is not a transaction affecting the rights of the preference shareholders though, in effect, it lessens their total voting power. *White v. Bristol Aeroplane Co. Ltd.*, (1953) 1 All ER 40; *Re, John Smith's Tadcaster Brewery Co. Ltd.*, (1953) 1 All ER 518. Similarly, the subdivision of any shares which has the effect of diminishing the voting power of other shares cannot be said to affect the right attached to any shares. See *Greenhalgh v. Arderne Cinema, Ltd.*, (1946) 1 All ER 512 (CA). The consolidation of shares of different classes into a single class with similar rights and privileges in the exercise of the power of alteration inserted in the memorandum or articles would not require sanction of the court unless alteration of the memorandum was itself involved. In this case such an alteration was involved because the share capital was being reorganised by abolishing the category of deferred shares and putting them at par with ordinary shares. *British India Corpn. Ltd. v. Shanti Narain*, (1935) 5 Com Cases 161 : AIR 1935 All 310. The enjoyment of the rights of preference shareholders is affected as a matter of business by the issue of additional preference shares with the same voting rights per share as those already existing, since the votes of the existing preference shareholders are diminished in respect of voting power, but the voting rights as such are not varied. Issue of preference shares out of the company's authorised capital in the exercise of the company's power under Memorandum and Articles, was held to be not a variation of the ordinary shareholders class rights. *Campbel v. Rofe*, (1933) AC 91 (PC). In *White v. Bristol Aeroplane Co. Ltd.*, (*Supra*), **applying** *Mackenzie & Co., Re*, (1916) 2 Ch 450 it was held that where there is rateable reduction on all shares, preference and ordinary, in pursuance of a clause in the articles authorising reduction of capital it is not an alteration of the rights of preference shareholders although diminishing the actual preferential dividend. A company may validly make a payment to the shareholders whose rights are adversely varied to secure acquiescence. *Caledonian Insurance v. Scottish American Investment Co. Ltd.*, 1951 SLT 23 (Scotland).

In all the above cases it may be noted the voting rights of the aggrieved shareholders had been as a fact, prejudicially affected, though the rights attached to their own shares were held not to be "varied" or diminished.

Such a result also **followed** in *Lord St. Davids v. Union Castle Steamship Co. Ltd.*, (1934) 78 Sol Jo 877 company's preference shareholders only had the right to vote when the preference dividend was in arrears or when their special preference rights were affected. The preference dividend came into arrears and the preference shareholders acquired the right of voting under the articles. The company then attempted to alter its articles so as to provide that the preference shareholders would have the right to vote at all times, whether the dividends were in arrears or not. The result of this would have been

that the preference shareholders, since they outnumbered the ordinary stockholders, would have been able to pass any resolution they wished, whether ordinary or extraordinary. The court agreed with the objections of ordinary stockholders and restrained the company from proceedings with the resolution. It would have involved ignoring what appears to have been a standard variation of rights clause in the articles. CLAUSON J. held that the articles gave the ordinary stockholders a right to approve such a change.

There is authority which implies that a company may unilaterally alter and convert one existing class of share into another. In *Re, The Stewart Precision Carburettor Company,* 1912 TLR 335, a company, whose share capital consisted of ordinary and preference shares, was allowed to convert certain unissued preference shares into ordinary shares and attach to all preference shares a right to participate *pari passu* with the ordinary shareholders in the surplus profits. The company had acted by way of a special resolution, passed and confirmed at a general meeting and also at a meeting of the preference shareholders, but not a separate meeting of ordinary shareholders. EVE J. nevertheless held that a separate meeting of the ordinary shareholders was unnecessary.

If a variation is effected in a manner satisfying the provisions of the section and in accordance with the memorandum and articles, the variation becomes complete and effectual and no further steps are necessary. *In re, Rampuria Cotton Mills Ltd.,* (1959) 29 Com Cases 85. Where a variation of rights is part of a scheme of arrangement with the intervention of the Court under section 391, section 106 does not apply. *Re, Hindustan General Electric Corporation,* (1959) 29 Com Cases 144 : AIR 1959 Cal 679.

Though the section as worded applies only to cases where the share capital of a company is divided into different classes of shares, there is nothing in it to prohibit the application of the principle to cases also of variation of rights where the share capital originally consisted of one class of shares and the company wanted to vary the rights and wanted to follow the procedure laid down in the section.

It would appear from this section that where three-fourths of the holders of shares of any class agree, the rights attached to the shares of that class may be varied. The section in terms does not insist upon giving notice to all the shareholders of that class. This may possibly lead to fraudulent variations of rights to the prejudice of the remaining one-fourth minority. It is, therefore, advisable that in all cases where variation of shareholders' rights is involved to send notice to all shareholders affected.

The section gives an option either to obtain the consent of three-fourths of the class of shareholders or to pass a special resolution at a separate meeting of that class. Separate meetings offer an opportunity to the class to discuss their own affairs undisturbed by the opposition of conflicting class interests. A single meeting with two separate polls will not be sufficient. *Imperial Chemical Industries Ltd., In re,* (1938) 8 Com Cases 181, 202, 203, 207 (HL) **affirming** (1938) 8 Com Cases 86 (CA). In a case before the Karnataka High Court, the articles provided that class rights should be altered by means of special resolution of the class of shareholders concerned. The Court held that an attempt to alter the class rights without compliance with this requirement of the articles was not valid. *Sitarama Reddy v. Bellary Spinning & Weaving Co. Ltd.,* (1984) 56 Com Cases 281 (Kar). In another case the articles of a company provided that the State Government, would have the power to nominate three directors on the company's Board, one of them being the chairman. The company subsequently increased its capital by offering rights shares to the existing shareholders. The State Government refused to take its proportion of the shares. Consequently, the company altered its article so as to deprive the State of its right of nomination to the Board. The alteration was held to be valid and effective. *State of Karnataka v. Mysore Coffee Curing Works Ltd.,* (1984) 55 Com Cases 70 (Kar). Since the Government did not by itself constitute a special class of shareholders the procedure of S. 106 was not applicable. See also comments on this case under S. 31.

If minority shareholders felt oppressed or prejudicially affected by any variation, the provisions of the next section should be invoked.

Where the articles of a company conferred the right upon a shareholder to the effect that as long as he was holding 10% of the company's shares he would have a right of pre-emption over the other issued shares and in respect of unissued shares and to appoint a director to the Board of directors, it was held that by virtue of these special rights he became a separate class of shareholders and his rights could be varied not simply by changing the articles but by following the procedure prescribed by the section. *Cumbrian Newspapers Groups Ltd. v. Cumberland and Westmorland Herald Newspapers and Printing Co. Ltd.*, (1987) 2 Comp LJ 39 : 1986 BCLC 286 (Ch D).

Provisions as regards the rights and privileges attaching to particular classes of shares are not required by statute to be inserted in the memorandum, but if they are stated in the memorandum without reservation of the power to modify or alter those rights and privileges, they cannot, in view of the provisions of Sections 17 and 106, be altered except in the mode and to the extent for which express provision is made in the Act. *Cf. British India Corpn. Ltd. v. Shanti Narain*, (1935) 5 Com Cases 161, 179 (All).

In *Re, Saltdean Estate Co. Ltd.*, (1968) 3 All ER 829 : (1969) 39 Com Cases 386 (Ch D) 'variation' has been held not to include cancellation of any class of shares. But cancellation of a particular class of shares has to be distinguished from abrogation of the rights attached to that class. 'Abrogation' is a 'variation' within the meaning of this section because S. 2(50) says that variation shall include abrogation and 'vary' shall include 'abrogate'.

Variation of dividend rights under statutory authorisation

Department's View.—The following query was raised before the Department: "After the passing of the Preference Shares (Regulation of Dividend) Act, 1960 the rates of dividend payable, whether less tax or free of tax, to Preference shareholders have been amended. As a result of this, the rights of shareholders have been altered. Since there is a special procedure provided for alteration of rights of holders of special classes of shares under section 106 of the Companies Act, if a company merely relying on the provisions of the Preference Shares (Regulation of Dividend) Act, declares a higher dividend, will it not be a contravention of the provisions of the Companies Act?

Incidentally it is still practicable to convene class meetings of Preference and Equity Shareholders in a company where it is possible to secure 3/4ths majority either by proxy or by consent letter of members on the rolls of the company. Amendment to section 106 has still not solved the problem as substitution of this procedure by a special resolution involves a change of Memorandum and Articles of Association which again involves the company in applying to the Court for sanction. This cumbersome procedure could have been avoided by a straight-forward amendment of section 106 enabling companies to secure variation of rights by special resolution without qualifying it by reference to Memorandum and Articles having to be altered."

The Department expressed the following view: "By virtue of sections 3 and 5 (1) of the Preference Shares (Regulation of Dividends) Act, 1960, preference shares issued and subscribed for before the 1st April, 1960 shall carry a right to be paid income-tax free dividend of 30 per cent notwithstanding anything contained in section 106 of the Companies Act. If any company wants to pay more to its preference shareholders requirements of section 106 of the Companies Act should be followed.

It is not possible to liberalise the provision of section 106 further as the financial interest of various classes of shareholders are involved. It may however be mentioned that as presumed in the query, alteration in Memorandum will not be necessary except where the capital clause needs to be changed." (*Department's F. No.* 8/16(1)61-PR).

Overriding effect of Section 80-A as inserted by Amendment Act, 1988

The section 80-A, as inserted by the Amendment Act of 1988 provides for compulsory redemption of irredeemable preference shares and preference shares which are not redeemable before the expiry at ten years [*Now Twenty years by the Companies Amendment Act, 1996*]. Such compulsory redemption does affect the rights of a class of shareholders, but this will not require the procedure of S. 106 to be observed. Section 80A has the overriding effect upon the procedure laid down in this section due to operation of law.

ICSI Guidance Note on Compliance Certificate (August, 2003)

Meeting of Class of Shareholders

Check whether:

(i) the meeting has been convened after duly complying with the provisions under relevant section and rule 7 of the Companies (Central Government's) General Rules and Forms, 1956 e.g., for reduction of capital, for variation of rights of shareholders as directed by Court;

(ii) the applicable provisions (e.g. those under section 102/106) have been duly complied with;

(iii) subject to directions of the Court, requirements relating to notice, attendance, Chairman, quorum, proxy, proxy register/instruments of proxy and conduct of meeting as well as maintenance of minutes of a general meeting have been complied with.

Check further—

whether there was any variation of rights of holders of special classes of shares? If so, check whether:

(i) there was a provision in the Articles/Memorandum of Association empowering the variation of shareholders' rights or such variation was not prohibited by the terms of the issue?

(ii) consent in writing of holders of 3/4th of the issued capital of that class has been received/special resolution of the holders of that class of shares passed?

(iii) Form 23 filed with the Registrar?

§ For full text of the Guidance Note on Compliance Certificate see *Appendix* 312.

Documents Involved: 1. Memorandum and Articles, 2. Prospectus(es)/terms and conditions of issue of the class of shares in question, 3. Minutes of Board/General Meeting, 4. Consent of Members, 5. Form 23.

S. 107. Rights of dissentient shareholders.—(1) If, in pursuance of any provision, such as is referred to in section 106, the rights attached to any such class of shares are at any time varied, the holders of not less in the aggregate than ten per cent of the issued shares of that class, being persons who did not consent to or vote in favour of the resolution for the variation, may apply to the [10][*Tribunal*] to have the variation cancelled, and where any such application is made, the variation shall not have effect unless and until it is confirmed by the [10][*Tribunal*].

(2) An application under this section shall be made within twenty-one days after the date on which the consent was given or the resolution was passed, as the case may be, and may be made on behalf of the shareholders entitled to make the application by such one or more of their number as they may appoint in writing for the purpose.

(3) On any such application, the [10][*Tribunal*], after hearing the applicant and any other persons who apply to the [10][*Tribunal*] to be heard and appear to the [10][*Tribunal*] to be interested in the application, may, if it is satisfied, having regard to all the circumstances of the case, that the variation would unfairly prejudice the shareholders of the class represented by the applicant, disallow the variation; and shall, if not so satisfied, confirm the variation.

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10. Subs. for the word "Court" by the Companies (Second Amendment) Act, 2002 (11 of 2003), s. 14.

(4) The decision of the [11][*Tribunal*] on any such application shall be final.

(5) The Company shall, within [12][thirty] days after the service on the company of any order made on any such application, forward a copy of the order[13] to the Registrar; and if default is made in complying with this provision, the company, and every officer of the company who is in default, shall be punishable with fine which may extend to [14][five hundred rupees].

NOTES

Eng. Act, 1948 : Sec. 72
Eng. Act, 1985 : Sec. 127

Previous Act : Sec. 66-A of Table A

Note : As and when the Companies (Second Amendment) Act, 2002 (11 of 2003) comes into force, the power under this section shall become transferred to the Tribunal to be exercised by it in place of the High Court. The commentary should be read keeping this change in mind.

Companies (Amendment) Act, 2000

Penalty enhanced.—The Amendment Act of 2000 enhanced the penalty amount from 50 rupees to 500 rupees under sub-section (5).

Companies (Second Amendment) Act, 2002 [11 of 2003]

The powers of Court under this section have been conferred on the Tribunal constituted under Part 1B of the Act. Consequential changes have accordingly been made in the section.

Dissenting shareholders' application [Sub-section (2)]

The reason for giving this right to dissidents is that a group of persons holding a class of shares may have divergent interests because some have and others have not additional interests in the company other than as members of that class. Preference shareholders may include some who also hold ordinary shares. This divergence of interest is a familiar phenomenon in cases where a court has been asked to sanction a scheme of arrangement following class meetings and in such a case the true position has been stated by ADAM J. in *Re, Chevron (Sydney) Ltd.*, (1963) VR 249 at 255 (Australia) as being that: "The court may treat the result of the voting at the meeting of the class as not necessarily representing the views of the class as such, and thus should apply with more reserve in such a case the proposition that the members of the class are better judges of what is to their commercial advantage than the court can be."

This section relates to the variation and abrogation of rights attached to shares and has no application to a cancellation of shares on a reduction of capital. *Saltdean Estate Co. Ltd., Re,* (1968) 3 All ER 829.

Where the variation is within the meaning of the section, the court has to be convinced that it unfairly prejudices the minority shareholders of the class. In such a case, apart from the remedy provided by this section, a common law action by a minority shareholder under the exceptions to *Foss v. Harbottle,* (1843) 2 Hare 461 is also possible. For the detailed discussion of the main rule and its exceptions, see, notes under Sec. 10, *ante.*

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11. **Subs. for the word "Court" by the Companies (Second Amendment) Act, 2002 (11 of 2003), s. 14.**
12. The word "thirty" was substituted for the word "fifteen" by s. 62 and Schedule to the Companies (Amendment) Act (XXXI of 1965) (w.e.f. 15-10-1965).
13. Filing of an authenticated copy of the Tribunal order in Form No. 21 of the Companies (Central Governments) General Rules & Forms, 1956.
14. The words "fifty rupees" substituted by the Companies (Amendment) Act, 2000, (53 of 2000) s. 43 (w.e.f. 13-12-2000).

The application must show that the applicant is authorised by the required percentage of the dissenting shareholders and that he did not consent to or vote in favour of the resolution. If he is proceeding on behalf of other members of his class also, he must also show his authority to act for them. *See Re, Suburban and Provincial Stores,* (1943) 1 All ER 342 : (1943) 13 Com Cases 180 (CA); *Re, Sound City (Films) Ltd.,* (1946) 2 All ER 521 : (1947) 17 Com Cases 142 (Ch D).

A sub-division of one class of shares is not a variation of the rights of another class, though that latter class may be affected thereby. *Greenhalgh v. Arderne Cinemas Ltd.,* (1945) 2 All ER 719.

Penalty for default [Sub-section (5)]

In case of default in forwarding the order of court to the Registrar within the specified time, the company and every officer thereof who is in default is punishable with fine up to five hundred rupees.

Compoundable offence.—The offence is compoundable under section 621A.

Prescribed Form.—Refer Rule 66 of the Companies (Court) Rules in *Appendix* 4 of the mode of presenting the petition and the contents of petition. A copy of the order passed under sub-section (3) shall be filed with Registrar within 30 days along with Form No. 21 as set out in *Appendix* 1.

Secretarial Practice Notes : Rights of dissentient shareholders

Check whether there were any orders by the Court cancelling/confirming the variations? If so, check whether a copy of the order had been forwarded to the Registrar in From 21 within thirty days of the order?

Documents Involved : 1. Register of Members, 2. Court Order, 3. Evidence of filing with Registrar, 4. Form 21, 5. Minutes of Board/General Meeting.

TRANSFER OF SHARES AND DEBENTURES

General Notes

Note : As and when the Companies (Second Amendment) Act, 2002 (11 of 2003) comes into force, the power under this section shall become transferred to the Tribunal to be exercised by it in place of the High Court. The commentary should be read keeping this change in mind.

TRANSFERABILITY of shares (which includes all kinds of corporate securities) is a great beneficial feature of incorporation. The investor in shares of an incorporated enterprise cannot withdraw his money from the company. He can only convert his investment into cash outside the company in the share market or by private sale. The company gets a permanent capital, the shareholder liquid investment. That is why from the very inception of public companies, free transferability of shares has been considered to be of primary importance. It is of the essence of incorporated companies that their shares should be transferable without any authoritative permission. The primary statutory declaration, therefore, is that shares are movable property capable of being transferred in the manner prescribed by the company's articles. There is this further declaration in S. 111A that the securities shall be freely transferable. Equation of shares with movable property has the effect of recognising that shares are equivalent to goods and are transferable as such. But even so shares cannot be regarded as ordinary marketable goods. They represent an investment which is held in a name and are symbolised by a document known as "share certificate" which is prepared and issued in a name, which name appears in the company's registers, the contents of which are also filed with the Registrar. Every change of ownership of shares involves replacement of one name by another name on all the relevant records. That is why documented formalities become necessary and are prescribed as a compulsory requirement. Without those formalities the transfer is not effective in the full sense of the word. It may have some force between transferor and transferee but it has no value in company relationship. In order to facilitate transactions in corporate securities, the Securities Contracts (Regulation) Act, 1956 has put the Stock Exchanges recognised under the Act on a statutory pedestal.

While free transferability is thus assured, permission is also given to companies to place reasonable restrictions on transferability. This became necessary to enable companies to safeguard their friendly or family identity in private companies and in the case of public companies to protect themselves from unscrupulous persons attempting to take-over control through market operations. Two provisions are mostly found in companies' articles. One of them gives a blanket power to the directors to refuse a transfer in their own discretion and other gives pre-emptive rights (found mainly in the articles of private companies) to existing shareholders. In the case of listed companies there can not be restriction on free transferability of shares.

In order to ensure that the discretion to refuse a transfer is not abused, two avenues were earlier provided. One was to apply to the Central Government under S. 111 and the other to the High Court under S. 155. Under the Amendment Act of 1988, these two provisions were combined. The Company Law Board, to the exclusion of the Court, was empowered to provide necessary remedy to the aggrieved person. In respect of shares which are listed on a recognised stock exchange, provisions were earlier contained in section 22A of Securities Contracts (Regulation) Act, 1956 permitting only four specific grounds of refusal and requiring that if the refusal was on account of the incompleteness of the documents, the parties should be informed and, in other cases, the company should

make a reference to the Company Law Board and the Board was to decide the issue after hearing parties. The result of this network of provisions was that refusal by a listed public company would require approval of the Company Law Board.

The Depositories Act, 1996 made far reaching changes. Section 22A of the Securities Contracts (Regulation) Act, 1956 has been omitted and a new section 111A has been inserted into the Companies Act, 1956 in the matter of transfer of shares of public listed companies. The effect of the new provisions is to assure that the shares in a public listed company are freely transferable. A listed company can refuse a transfer only if the transfer involves violation of SICA or SEBI Regulations or any other law for the time being in force. The company may not be able to know whether there is a legal violation. The affected party may have to take a court stay order. Where a transfer has been registered inspite of any violation of the above kind, the CLB has been authorised to order rectification of the situation. During the course of enquiry, the Board may suspend voting rights in respect of impugned securities. The provisions of s. 111 are now confined in their operation only to private companies.

Transfer of Shares and Debentures

S. 108. Transfer not to be registered except on production of instrument of transfer.—(1) A company shall not register a transfer of shares in, or debentures of the company, unless a proper instrument of transfer duly stamped and executed by or on behalf of the transferor and by or on behalf of the transferee and specifying the name, address and occupation, if any, of the transferee, has been delivered to the company along with the certificate relating to the shares or debentures, or if no such certificate is in existence, along with the letter of allotment of the shares or debentures:

Provided that where, on an application in writing made to the company by the transferee and bearing the stamp required for an instrument of transfer, it is proved to the satisfaction of the Board of Directors that the instrument of transfer signed by or on behalf of the transferor and by or on behalf of the transferee has been lost, the company may register the transfer on such terms as to indemnity as the Board may think fit:

Provided further that nothing in this section shall prejudice any power of the company to register as shareholder or debenture-holder any person to whom the right to any shares in, or debentures of, the company has been transmitted by operation of law.

[1][(1-A) Every instrument of transfer of shares shall be in such form as may be prescribed[2], and—

(a) every such form shall, before it is signed by or on behalf of the transferor, and before any entry is made therein, be presented to the prescribed authority, being a person already in the service of the Government, who shall stamp or otherwise endorse thereon the date on which it is so presented, and

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1. Sub-sections (1-A), (1-B), (1-C) and (1-D) were inserted by section 13 of the Companies (Amendment) Act (XXXI of 1965); but again, sub-sections (1-A), (1-B) and (1-C) were amended in their present form by the Companies (Amendment) Act (XXXVII of 1966), with provision that they shall be deemed to have come into effect on 1st April, 1966.
2. Prescribed Form is Form 7B *vide* R. 5A(2) of Companies (Central Government's) General Rules & Forms, 1956 and Form 7BB in case of OTCEI.

(b) every instrument of transfer in the prescribed form[3] with the date of such presentation stamped or otherwise endorsed thereon shall, after it is executed by or on behalf of the transferor and the transferee and completed in all other respects, be delivered to the company,—

(i) in the case of shares dealt in or quoted on a recognised stock exchange, at any time before the date on which the register of members is closed, in accordance with law, for the first time after the date of presentation of the prescribed form to the prescribed authority under clause (a) or within [4][twelve months] from the date of such presentation, whichever is later;

(ii) in any other case, within two months from the date of such presentation.

(1-B) Notwithstanding anything contained in sub-section (1-A), an instrument of transfer of shares, executed before the commencement of section 13 of the Companies (Amendment) Act, 1965 (XXXI of 1965), or executed after such commencement in a form other than the prescribed form, shall be accepted by a company,—

(a) in the case of shares dealt in or quoted on a recognised stock exchange, at any time not later than the expiry of six months from such commencement or the date on which the register of members is closed, in accordance, with law, for the first time after such commencement, whichever is later;

(b) in any other case, at any time not later than the expiry of six months from such commencement.

(1-C) Nothing contained in sub-sections (1-A) and (1-B) shall apply to—

(A) Any share—

(i) which is held by a company in any other body corporate in the name of a director or nominee in pursuance of sub-section (2), or as the case may be, sub-section (3), of section 49, or

(ii) which is held by a corporation, owned or controlled by the Central Government or a State Government, in any other body corporate in the name of a director or nominee, or

(iii) in respect of which a declaration has been made to the Public Trustee under section 153-B,

if—

(1) the company or corporation, as the case may be, stamps or otherwise endorses, on the form of transfer in respect of such share, the date on which it decides that such share shall not be held in the name of the said director or nominee or, as the case may be, in the case of any share in respect of which any such declaration has been made to the Public Trustee, the Public Trustee stamps or otherwise endorses, on the form of transfer in respect of such share under his seal, the date on which the form is presented to him, and

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3. Prescribed Form is Form 7B *vide* R. 5A(2) of Companies (Central Government's) General Rules & Forms, 1956 and Form 7BB in case of OTCEI.
4. The words "two months" subs. by the Companies (Amendment) Act, 1988 (w.e.f. 15-6-1988).

(2) the instrument of transfer in such form, duly completed in all respects, is delivered to the—

(a) body corporate in whose share such company or corporation has made investment in the name of its director or nominee, or

(b) company in which such share is held in trust,

within two months of the date so stamped or otherwise endorsed; or

(B) any share deposited by any person with—

(i) the State Bank of India, or

(ii) any scheduled bank, or

(iii) any banking company (other than a scheduled bank) or financial institution approved by the Central Government by notification in the Official Gazette (and any such approval may be accorded so as to be retrospective to any date not earlier than the 1st day of April, 1966), or

(iv) the Central Government or a State Government or any corporation owned or controlled by the Central Government or a State Government,

by way of security for the repayment of any loan or advance to, or for the performance of any obligation undertaken by, such person, if—

(1) the bank, institution, Government or corporation, as the case may be, stamps or otherwise endorses on the form of transfer of such share—

(a) the date on which such share is returned by it to the depositor, or

(b) in the case of failure on the part of the depositor to repay the loan or advance or to perform the obligation, the date on which such share is released for sale by such bank, institution, Government or corporation, as the case may be, or

(c) where the bank, institution, Government or corporation, as the case may be, intends to get such share registered in its own name, the date on which the instrument of transfer relating to such share is executed by it; and

(2) the instrument of transfer in such form, duly completed in all respects, is delivered to the company within two months from the date so stamped or endorsed.

Explanation.—Where any investment by a company or a corporation in the name of its director or nominee referred to in clause (A)(i) or clause (A) (ii), or any declaration referred to in clause (A)(iii), or any deposit referred to in clause (B), of this sub-section is made after the expiry of the period or date mentioned in clause (a) of sub-section (1-B) or after the expiry of the period or date mentioned in clause (b) of that sub-section, as the case may be, the form of transfer, in respect of the share which is the subject of such investment, declaration or deposit, means the prescribed form;

or

(C) any share which is held in any company by the Central Government or a State Government in the name of its nominee, except that every instrument of

transfer which is executed on or after the 1st day of October, 1966, in respect of any such share shall be in the prescribed form.

(1-D) Notwithstanding anything in sub-section (1-A) or sub-section (1-B) [5][or sub-section (1-C)] where in the opinion of the Central Government it is necessary so to do to avoid hardship in any case, that Government may on an application[6] made to it in that behalf, extend the periods mentioned in those sub-sections by such further time as it may deem fit, [7][whether such application is made before or after the expiry of the periods aforesaid]; and the number of extensions granted hereunder and the period of each such extension shall be shown in the annual report laid before the Houses of Parliament under section 638.]

(2) In the case of a company having no share capital, sub-section (1) shall apply as if the references therein to shares were references instead to the interest of the member in the company.

[8][(3) Nothing contained in this section shall apply to transfer of security effected by the transferor and the transferee both of whom are entered as beneficial owners in the records of a depository.]

NOTES

Eng. Act, 1948 : Sec. 75
Eng. Act, 1985 : Sec. 183(1)(2)

Previous Act : Secs. 34 to 37

Companies (Amendment) Act, 1965

Restriction on currency of blank transfers.—The Companies (Amendment) Act (XXXI of 1965), has inserted sub-sections (1-A), (1-B), (1-C) and (1-D).

The original Amendment Bill contained only sub-section (1-A) and in respect of it, the Notes on clauses stated:—

"The new sub-section (1-A) of section 108 seeks to impose restrictions on the period of currency of blank transfers on the lines of the recommendation in paragraph 19 of the Commission's Report. The proposed restrictions are—

(a) that every instrument of transfer shall be in the prescribed form bearing the date of issue stamped by the prescribed authority; and

(b) that the said instrument is required to be delivered to the company within six months from the date of issue in the case of listed shares and within two months from that date in the case of any other shares.

These restrictions are designed to curb the abuse inherent in the system of blank transfer." (clause 1-B).

The Joint Select Committee on the Bill added sub-sections (1-B), (1-C) and (1-D), giving their reasons as follows:—"The Committee are of the opinion that an instrument of transfer, executed before the coming into force of this measure but which is not in conformity with the proposed provisions of sub-section (1-A) of section 108 of the principal

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5. Added by the Companies (Amendment) Act (XXXVII of 1966), which also provided that the amendment shall be deemed to have been inserted on the 1st April, 1966.
6. Form 7C *vide* Rule 5-A(4) of Companies (Central Government's) General Rules & Formsis the prescribed format of Application.
7. Added by the Companies (Amendment) Act (XXXVII of 1966), which also provided that the amendment shall be deemed to have been inserted on the 1st April, 1966 (w.e.f. 1-4-1966).
8. Ins. by the Depositories Act, 1996 (w.e.f. 20-9-1995).

Act, should also be accepted by a company up to a period of six months from the date of coming into force of the Companies (Amendment) Act, 1965.

The committee also feel that the provisions of this clause should not prevent any person from depositing, by way of security, any shares with the State Bank of India or any scheduled bank or financial institution approved by the Company Law Board by notification in the Official Gazette.

The Committee further feel that in order to avoid hardship in any case, the Company Law Board should be empowered, on an application made to it in that behalf, to extend the period mentioned in the proposed sub-sections (1-A) and (1-B) in the clause by such further time as that Board might deem fit. Information relating to the number of extensions so granted by the Board and the period of each extension should, however, be furnished in the annual report laid before the Houses of Parliament under section 638 of the Companies Act, 1956.

The clause has been amended accordingly. (*Report*: para 17).

Companies (Amendment) Act, 1966

All the provisions (1-A), (1-B), (1-C) and (1-D) were further modified and adopted in their present form, by Act of 1966, the objects and reasons for the changes were thus stated:—Section 108 of the Companies Act relating to transfer of shares and debentures was amended by the Companies (Amendment) Act, 1965 in pursuance of the recommendations of the Vivian Bose Inquiry Commission. The object of the amendment was to regulate and control the currency of blank transfer of shares. For this purpose new sub-sections (1-A) to (1-D) were inserted in section 108. These new provisions were brought into force on the 1st April, 1966. But immediately thereafter, questions arose as to whether the effect of these new provisions was only to regulate and control the currency of blank transfer of shares or to prohibit them altogether. As views were divergent on this point, it was thought that in order to maintain the smooth functioning of the stock-exchanges and capital market it should be made clear that the object underlying the new provisions was not to prohibit blank transfers altogether but only to restrict their currency. By the amendments inserted in section 108 by the Amending Act of 1965, some other recommendations of the Vivian Bose Inquiry Commission were also not given effect to. As stock-exchanges and capital market were directly involved in the matter, urgent legislative action was called for; but as Parliament was not in session, the situation was met by the promulgation of an Ordinance by the President on the 21st September, 1966. The Bill seeks to replace the Ordinance.

Companies (Amendment) Act, 1988

As per clause 15 of the Notes on clauses, section 108(1A) has been amended by the Amendment Act of 1988 to facilitate transferability of shares listed on the stock exchange, extending the period of currency of share transfer instruments from two months to twelve months.

Depositories Act, 1996

The Depository Act, 1996 has introduced by way of consequential amendments sub-section (3) to this section. The new sub-section provides that the formalities prescribed by s. 108 shall not apply to any transfer of securities between a transferor and transferee both of whom are entered as beneficial owners in the records of a depository. One of the effects of this exemption from the operative requirement of s. 108 is that a lot of paper work, manual handling and postage and affixation of stamps would be saved, where transfers are effected through the mechanism provided by the depository system. The section will however continue to apply to transfers effected outside the depository mechanism.

Depository—how it functions.—A depository is an organisation where the securities of an investor are held in the electronic form at his request through the medium of a De-

pository Participant (DP). If the investor wants to utilize the services offered by a Depository, the investor has to open a beneficiary account with the Depository through a DP. DP is the representative or agent in the depository system (like a broker who trades on behalf of the investors in and outside the Stock Exchange), and he maintains the investor's securities account balances and intimates to him the status of his holdings from time to time. The investor can open accounts with one or more DPs. When a person buys any security *e.g.* shares or debentures already in the depository mode, the buyer will become the owner of the said security in the depository within a day of the settlement being completed. The buyer is not required to apply to the company for registering the security in his name. Dematerialisation is the process by which physical certificates of an investor, at his request, are taken back by the company and actually destroyed and an equivalent number of securities are credited in the electronic holdings of the investor. For this, the investor will have to first open an account with a DP and then request for dematerialisation of his certificates through the DP so that the de-materialised holdings can be credited into that account. If the investor wishes to get back his securities in the physical form, he has to make a request to his DP, for re-materialisation of the same. Re-materialisation is the term used for converting electronic holdings back into certificates. Investor's DP will forward the request to the National Securities Depository Limited (organisation promoted by the IDBI, UTI and NSE to provide electronic depository facilities for securities traded in the Equity and Debt market).

When any corporate event *e.g.* rights, bonus or dividend is announced by a company for its particular security, the Depository will give all the details of the investors having electronic holdings of that security on record date/book closure to the company (or its Registrars and Share Transfer Agent). The disbursement of the cash benefits *e.g.* dividend or interest to the investor will be done by the company (or its Registrars), whereas the distribution or allotment of securities entitlement will be done by the Depository based on the information furnished by the company (or its Registrars).

The investor has to pay charges to the Depository and the DP for opening of account and also for every transaction in the account.

§ See also Notes under section 150 under the heading 'Depository Systems'.

Further study.—For a further study of the various aspects of dematerialisation and of paperless securities see DR. EVA MICHELER, FAREWELL QUASI-NEGOTIABILITY LEGAL TITLE AND TRANSFER OF SHARES IN A PAPERLESS WORLD, 2002 JBL 358. The author says : "Dematerialisation has improved the safety and reliability of share transfers in several ways. Settlement times are much shorter now than they used to be, and the delivery of securities is closely linked to the transfer of the purchase price. This has reduced the risk involved in share transfers. The buyer and the seller are protected to a greater extent than they used to be against each other's default risk". Since the application of the principles developed by the common law has not been expressly ruled out, the author explains in the following words how they will apply in the changed environment : [*Ibid* at p. 378].

"When paper documents are used to transfer shares, English law can achieve quasi-negotiability of registered shares by applying the rules of novation and the rules on estoppel. The rules enhancing the transferability of shares did not develop because paper documents were used to transfer shares. They developed because shares are issued to circulate in an anonymous market and this purpose is best achieved by insulating the transferee against the risk of defective issues and unauthorised transfers. The risk of defective issues and forged transfers is placed on the issuer because he is ultimate beneficiary of the rules providing for enhanced transferability. He will find it easier to raise finance for his operations if the risk involved in transferring the securities he creates is low. He therefore has the greatest incentive to improve the transfer mechanism. These considerations support the application of the common law rules in a paper environment as well as in a dematerialised environment. The application of the common law rules to uncertificated shares is, however, difficult to support by orthodox theory."

Appeal to Securities Appellate Tribunal [S. 23A of Depositories Act, 1996]

Any person aggrieved by an order of SEBI made under the Depositories Act, 1996 or the Regulations made thereunder may prefer an appeal to the Securities Appellate Tribunal established under section 15K of the SEBI Act, 1992.

§ For text of SEBI Appellate Tribunal (Procedure) Rules, 2000 see *Appendix* 153.

Dematerialisation of GDRs/ADRs

Delivery of underlying shares of GDRs/ADRs shall compulsorily be in dematerialised form. The RBI has issued two Notifications on the subject permitting:

(*a*) a non-resident holder of ADRs/GDRs issued by a company registered in India, to acquire, upon surrendering ADRs/GDRs, the underlying shares when such shares are released by the Indian custodian of the ADR/GDR issue, and

(*b*) the company whose shares are so released, or a depository defined in clause (2) of sub-section (1) of section 2 of the Depositories Act, 1996 to enter in its register or books, in which securities are registered or inscribed, and address outside India of the non-resident holder of shares.

RBI has further clarified that there would not be any obstacle from FERA angle in the process of dematerialisation as the abovementioned notifications have been issued to take care of the same. Copies of the notifications are enclosed herewith.

It has therefore been decided that henceforth delivery of underlying shares of GDRs/ADRs shall compulsorily be in dematerialised form. Stock Exchanges shall not accept delivery of underlying shares of GDRs/ADRs in physical form.

Permission for acquisition/purchase of shares acquired on surrender of ADRs/GDRs

Notification No. FERA 193/99-RB, Dated 16-3-1999, Issued by the Exchange Control Department, RBI.—In exercise of the powers conferred by clause (*b*) of sub-section (1) of section 29 and clause (*b*) of sub-section (4) of section 19 of the Foreign Exchange Regulation Act, 1973 (46 of 1973), the Reserve Bank hereby permits:

(*a*) a non-resident holder of ADRs/GDRs issued by a company registered in India, to acquire, upon surrendering ADRs/GDRs, the underlying shares when such shares are released by the Indian Custodian of the ADR/GDR issue, and

(*b*) the company whose shares are so released, or a depository defined in clause (2) of sub-section (1) of section 2 of the Depositories Act, 1996 to enter in its register or books, in which securities are registered or inscribed, an address outside India of the non-resident holder of shares.

Notification No. FERA 194/99-RB, Dated 16-3-1999, Issued by the Exchange Control Department, RBI.—In exercise of the powers conferred by sub-section (6) of section 19 of the Foreign Exchange Regulation Act, 1973 (46 of 1973), the Reserve Bank, being of the opinion that it is necessary and expedient in the public interest to do so, directs that its Notification No. FERA 185/98-RB, dated 19th August 1998 shall be amended in the following manner, namely:

In the said Notification No. FERA 185 for the words "underlying GDR/ADR issue of a company registered in India" the words "acquired on surrendering GDRs/ADRs issued by a company registered in India" shall be substituted. [*SMDRP/POLICY/CIR.9/99, dated 29-4-1999, issued by the Secondary Market, SEBI*].

Fema, 1999.—See also Para 4 ('Issue of shares by international offering through ADR/GDR') and paras 4A and 4B (two-way fungibility of ADRs and GDRs) of Schedule I (Foreign Direct Investment Scheme) to FEM (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000 issued by RBI under FEMA, 1999.

§ See also Notes under section 72.

Dematerialisation of Securities—trading and settlement

The Working Group on dematerialisation of securities at its meeting held on May 3, 1999 suggested that the stock exchanges should provide an additional trading window, which would give one time facility for small investors to sell physical shares (which are in compulsory demat list) not exceeding 500 shares in number irrespective of their value. As of now, this facility is available at the Stock Exchange, Mumbai (BSE), National Stock Exchange (NSE), Delhi Stock Exchange (DSE) and Calcutta Stock Exchange (CSE).

It has now been decided that all the stock exchanges shall introduce the scheme for small investors by providing similar trading facility. This facility shall be available only to registered holders of shares. The shares standing in the name of individuals/HUF shall alone constitute a good delivery. The selling/delivering member must necessarily be the introducing member. The buyers of the shares shall not be permitted to reintroduce the shares in the market in the physical form. This facility should be made available on all trading days.

All the Stock Exchanges shall introduce this scheme urgently for small investors under intimation to SEBI and also advise the member brokers not to reject any client's request for trading in this segment. [*SMDRP/POLICY/CIR-21/99, dt. 8-7-1999, Issued by the SEBI*].

Depositories related statutory material

Following is the statutory material issued by SEBI related to Depository. For the texts, see respective Appendices:

1. Depositories Act, 1996 [*Appendix* 199]
2. SEBI (Depositories and Participants) Regulations, 1996 [*Appendix* 201]
3. SEBI (Custodian of Securities) Regulations, 1996 [*Appendix* 202]
4. Prescribed Uniform Norms & Practices for Custodian of Securities, 1996 [*Appendix* 204].
5. Depositories (Appeal to Central Government) Rules, 1998 [*Appendix* 200]
6. SEBI Appellate Tribunal (Procedure) Rules, 2000 [*Appendix* 153]
7. Depositories (Appeal to Securities Appellate Tribunal) Rules, 2000, (w.e.f. 18-02-2000) [*Appendix* 203]

Companies (Amendment) Act, 2000

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*]

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*].

Issue of Shares Certificate in case of IPOS and trading in demat form

Pursuant to the discussion in the meeting of all the stock exchanges held on 17th January, 2001 the stock exchanges are advised to implement the following:

SEBI has mandated that all the shares allotted under new initial public offerings (IPOs) will be traded in demat form only in all the exchanges. Investors, however, have the right to obtain and hold physical share certificate, though these will need to be dematerialised before sale of securities. Currently, the listing agreement provides that the physical share certificates are to be issued in market lots only. It has now been decided that in the case of IPOs the issuer company may issue a single share certificate to any investor who wishes to obtain physical share certificates unless otherwise specifically requested by him. [*SMDRP/Policy/Cir-12/01 dt. 28-2-2001, issued by the Secondary Market Department*]

Instrument of Transfer and Share Certificate [Sub-section (1)]

It is an essential condition for registering a transfer of shares or debentures that a duly stamped instrument satisfying the requirement of sub-section (1) should be delivered to the company accompanied by the certificate or letter of allotment relating to the shares or debentures. Note that while the proviso excuses the production of the instrument of transfer in case it was lost, there is no excuse for the non-production of the certificate or allotment letter. That is to say, there can be no registration of a transfer without production of the certificate or allotment letter. If it is lost, a duplicate certificate as provided by the Share Certificate Rules, must be obtained and then alone the transfer can be effected on production of the duplicate. The use of the words "shall not transfer" indicates that the provision is mandatory and that it will be unlawful to register a transfer unless the requirements of the section are complied with. See *Jayantilal v. Gordhandas Desai Pvt.*

Ltd., (1968) 38 Com Cases 405 (Bom). See also *Department's view in Company News and Notes* July 1963 issue. In *Mannalal Khetan v. Kedar Nath Khetan,* (1977) 47 Com Cases 185 : AIR 1977 SC 536, the Supreme Court in construing the expression 'shall not register' occurring in section 108 (1) pointed out that, where the language used is in the negative form, it 'emphasises the insistence of compliance' with the provisions concerned and is intended as a legislative device to make a statutory provision imperative. [In this case the original share certificates and transfer Forms were in the custody of the shareholder's receiver and therefore the shareholder was not able to exercise the right of transfer in reference to the shares of which he was the registered owner.].

'Proper instrument' means an instrument which complies with all the formalities required by the Act, including the stamp duty required to be affixed. See *Re, Paradise Motor Co. Ltd.,* (1968) 2 All ER 625 : (1968) 2 Comp LJ 216 (CA). The rule of substantial compliance does not apply. Shares in different companies cannot be transferred by a single transfer form. There must be separate instrument of transfer for the shares in each company. *P.J. Thakar v. V.R. Shelat,* (1973) 43 Com Cases 203, 214 (Guj). **Overruled** on another ground by Supreme Court in *Vasudev Ramchandra Shelat v. Pranlal Jayanand Thakar,* (1975) 45 Com Cases 43 (SC). Where in the column of the transferee in the transfer form the name of a company not yet incorporated was shown, it was held that the instrument was not validly executed for the purposes of section 108 because a company cannot be a transferee before its incorporation. *Inlec Investment (P.) Ltd. v. Dynamatic Hydraulics Ltd.,* (1989) 3 Comp LJ 221 (CLB). In addition to this, the requirements of the company's articles must also be satisfied. Where, *e.g.*, the article requires the payment of transfer fee in the office of the company, depositing the same in the court was held to be not a sufficient compliance. *Chandran (P.V.) v. Malabar & Pioneer Hosiery (P.) Ltd.,* (1985) 57 Com Cases 570 **affirmed** in (1990) 69 Com Cases 164 (Ker—DB).

A transfer deed executed by the transferor alone does not pass the title in the shares to the transferee. The transfer deed must be executed by the transferee as well as the transferor. *Nagabhushanan v. Ramachandra Rao,* AIR 1923 Mad 241. Where the transfer form did not show the transferor's address and the distinctive numbers of the shares the same was held to be not void because those particulars were verifiable from the accompanying share certificate. *Letheby & Christopher Ltd., Re,* (1904) 1 Ch 815.

A company may be restrained by injunction from effecting a transfer where the requirements of this section are not complied with. *Somani (K.K.) v. Somani (D.K.),* (1986) 59 Com Cases 910 (All). A provision in a company's articles enabling directors to accept a transfer without an instrument of transfer was held to be in violation of the Companies Act. *Madhava Ramchandra Kamath v. Canara Banking Corpn. Ltd.,* (1941) 11 Com Cases 78 at 81 : AIR 1941 Mad 354. Directors in this case attempted to sell the shares of a member whom they had earlier expelled and the expulsion being bad in law, the transfer of shares was also unauthorised. A company cannot be compelled to rectify its register of members and to register a share purchaser's name unless the certificates for the relevant shares are made available to the company alongwith the instrument of transfer. *Pravin Agarwal v. Reckitt & Colman of India Ltd.,* (2000) 37 CLA 119 (CLB–EB).

The gift of a part of dividend received on certain shares does not amount to a gift of the corpus of shares also. *Khadija v. P.K. Mohammed (P.) Ltd., In re,* (1985) 58 Com Cases 543 (Ker).

Signature per pro on transfer form

The *Madhav Ram Chandra Kamath* case, (1941) 11 Com Cases 78 was decided under the 1913 Act in which there was no provision for transfer form being signed on behalf of the transferor. But 1956 Act, section 108(1), clearly provides that the transfer form may be signed by the transferor or on his behalf. Hence, if a provision in a company's articles authorised the director to sign the share transfer form on behalf of a member who had been expelled and, was required to compulsorily transfer his shares, the director's refusal to sign the execution of the transfer form was valid under the 1913 Act. *Gowthami Sol-*

vent Oils Ltd. v. Mallina Bharathi, (2001) 105 Com Cases 710 at 720 : (2001) 31 SCL 178 (AP). The CLB decision in *Mallina Bharathi v. Gowthami Solvent Oils Ltd.,* (2001) 105 Com Cases 700 : (2001) 41 CLA 188 : (2001) 31 SCL 60 (CLB-SR) was uphled on the point that expulsion in the case was not proper.

The respondent company was a deemed public company under section 43A of the Act.

§ For notes see under section 41 under the heading "Expulsion from membership."

Application for split transfer and for less than market lots

It was held in *Kumar Exporters Pvt. Ltd. v. Naini Oxygen, Acetylene & Gas Ltd.,* (1985) 58 Com Cases 97 (All) that where a duly executed transfer form was accompanied by a certificate pertaining to a larger number of shares than those purported to be transferred, the requirement of this sub-section were sufficiently complied with. The Court observed:

> The intention of holding section 108 to be mandatory is only to the extent that the company must have before it the Share Transfer Form duly executed and stamped along with the Share Transfer Certificate; but it cannot be interpreted to mean that even when a Share Certificate is there, though for a larger amount, there is non-compliance of section 108. The larger share certificate includes the shares sought to be transferred, and as such, there would be full compliance of section 108, if an application for transfer of a smaller number of shares is accompanied by a share certificate relating to a larger number of shares. Further, section 112 lays down the procedure for certification of transfers. Certification, in effect, means a statement by the company that certain documents have been delivered to the company for the purpose of transfer of shares. It is a kind of receipt. It is a representation by the company to any person acting on the faith of such certificate that documents show a *prima facie* title to the shares in the transferor's name in the instrument of transfer. This provision has been made to facilitate the sale of smaller number of shares in case the certificate is for a larger number of shares. If Parliament contemplated that no transfer could be made unless the share certificate was split up, it was not necessary to make any such provision as has been made in section 112. Thus, there is no prohibition laid down in any section of the Companies Act that a party cannot apply for transfer along with a certificate for larger shares, unless sub-division is made earlier. The mere fact that the certificate was not sub-divided earlier, did not take away the power of the company to record the transfers sought by the petitioner.

In *Dipak Kumar Jayantilal Shah v. Atul Products Ltd.,* (1995) 82 Com Cases 603 (CLB) **following** these authorities of CLB held that a provision in a company's articles that share transfer in less than market lots of 50 would not be accepted was *void.* This approach of the CLB was **not approved** by the Gujarat High Court in *Atul Products Ltd. v. Dipak Kumar Jayantilal Shah,* (1997) 88 Com Cases 876 (Guj). The court was of the view that a company cannot be compelled to accept a transfer in violation of the listing agreement and its own articles based on its listing agreement. The company had not refused to accept the transfer as such. Its objection was only this that four out of five shares were being transferred one each to four different transferees. The member was given the option valid for one month to approach the company again for accepting the transfer of the lot of five shares in the name of a transferee or transferees as he might desire.

§ See also Notes under s. 111 under heading "Policy of accepting not less than shares in a transferable lot".

Rejected instrument of transfer

Where an instrument of transfer was presented for registration and rejected by the company on grounds which were upheld by the appellate authorities, it was held by the CLB that presenting the same instrument again after a long time and with no change except some kind of validation by the Registrar of Companies which itself was not proper was a bad delivery. An instrument which becomes invalid by efflux of time cannot be revalidated by the Registrar. Such an instrument would also not be saved by section 22A of the Securities Contracts (Regulation) Act, 1956. *Mathew Michael v. Teekoy Rubber and Tea Co. Ltd.,* (1994) 79 Com Cases 370 (CLB); *Thomas Michael v. Teekoy Rubber and Tea Co. Ltd.,* (1994) 79 Com Cases 370 (CLB).

Requirement of producing instrument of transfer

Department's Clarification.—The following query was raised before the department: "Section 108 makes a specific provision only for the contingency of loss of the instrument of transfer but not for the loss of the certificate or allotment letter. It may happen that a purchaser of shares loses both the share certificate and the instrument of transfer. Section 108 being mandatory, can a company give effect to a transfer where both the certificate or allotment letter and the instrument of transfer are lost, if the loss is proved to the satisfaction of the Board and indemnity as the Board may require is furnished by the transferee along with an application signed with the stamps required for the instrument of transfer affixed thereon, and also issue a duplicate certificate to the transferee? The Department expressed the following view: "In the opinion of the Department section 108 only envisages the case where the instrument of transfer is lost. If, therefore, the share certificate or the allotment letter is also lost then, a duplicate thereof will have to be obtained first. Reference is also invited in this connection to the provisions of rule 4(3) of the Companies (Issue of Share Certificates) Rules, 1960. (*Company News and Notes,* dated 1-7-1963).

Transfer of shares without proper instrument

Where no proper transfer of shares has been executed in favour of a person whose name has been entered in the register of members, the person whose name is so entered and who is a transferee without consideration, becomes a constructive trustee of the person to whom the shares belonged. An order can be made for rectification of the share register of the company directing the company to delete the name and put back the name of the person in whose name the shares originally stood. *International Credit and Investment Co. (Overseas) Ltd. v. Adham,* (1994) 1 BCLC 66 (Ch D). Where the records showed that the shares in question were transferred without lodgment of the original share certificates and share transfer form, the CLB said that this was a violation of s. 108. It was further found that the requirement of valid consideration was also not substantiated. The duplicate share certificates were issued by the company on a date subsequent to the lodgment. Such serious discrepancies in the sequence of execution of the transfer showed that the transfer was not valid. The transfer was ordered to be removed from the register. *Shailesh Rajnikant Parekh v. Starline Travels P. Ltd.,* (2004) 118 Com Cases 145 (CLB).

Comparison between transfer and transmission

There is a difference between transfer of a share which is a voluntary act of a shareholder and transmission which is by operation of law. "Transmission" means with regard to shares that on the death of the last holder of shares there is by operation of law an instantaneous transfer of ownership to the heirs of the last holder from the moment of death. It may be necessary to obtain a succession certificate or letters administration, but the property is deemed to vest not on the date of grant of the certificate, but on the date of death. This position is recognised by the enactment of the second proviso to section 108(1). *Margaret T. Desor v. Worldwide Agencies (P.) Ltd.,* (1989) 66 Com Cases 5 (Del). **Affirmed** by the Supreme Court on other point in *World-wide Agencies (P.) Ltd. v. Margaret T. Desor,* (1990) 67 Com Cases 607 : AIR 1990 SC 737. See also, *LIC v. Bokaro and Ramgur Ltd.,* (1966) 36 Com Cases 490 (Del).

Relevant Rules and prescribed Transfer Form [Sub-section (1-A)]

For prescribed form and relevant Rules for transfer of shares please refer Form No. 7-B and Form 7BB and Rule 5-A of the Companies (Central Government's) General Rules and Forms, 1956, in *Appendix* 1.

§ For the text of the Rules and Form 7BB see *Appendix* 1.

Share Transfer Form in case of Companies listed with OTCEI

Form No. 7BB has been prescribed in case of companies listed with OTCEI w.e.f. 26-5-1995 *vide* Rule 5-A(2A) of Companies (Central Govt.) General Rules and Forms, 1956.

Issue of Counter Receipts dispensed with by OTCEI.—1. The amendments to the Companies (Central Government) General Rules & Forms, 1956 have been done at the request of OTCEI (Over The Counter Exchange of India) who have since decided to switch over from paperless trading of securities to trading in physical certificates. OTCEI has proposed to bring about the change-over in a phased manner. As a

first step, the companies whose securities are traded in OTCEI would stop issuing counter receipts (in lieu of share certificates) with effect from February 28, 1999. The existing counter receipts would be allowed to be traded at OTCEI only for a limited period and would be stopped thereafter.

2. *Notification* No. GSR 16(E), dated January 6, 1999, amends the Companies (Central Government's) General Rules and Forms, 1956. It replaces the existing sub-rule (2A) of rule 5A with a new sub-rule (2A). This amendment merely facilitates continued use of Form 7BB as the form of application for share transfer so long as counter receipts are allowed to be traded.

3. *Notification* No. GSR 17(E), dated January 6, 1999, amends the Companies (Issue of Share Certificates) Rules, 1960. This notification provides that with effect from February 28, 1999, companies whose securities are traded in OTCEI would not issue counter receipts. [*Notification No. GSR 16(E)*—see (1999) 95 Com Cases (St) 131 and *GSR No. 17(E)*—see (1999) 95 Com Cases (St.) 131, dated January 6, 1999]

Share Transfer Form (Form 7B) for Endorsement

Department's Circular.—"The words 'any entry' in clause (a) of sub-section (1-A) of Section 108 of the Companies Act, 1956 should mean 'any material entry'. Drastic rewriting of the statute is involved in understanding those words in that way, because under the provision of law as it stands at present, it is that form that is stamped and *not* the instrument of transfer. Therefore, merely filling in the name of the company alone would not disqualify the form (Form 7B)." (*Circular No.* 10/73, dated 19-5-1973)

Time for lodgement of transfer documents [Sub-section (1-A)]

Where documents for transfer of shares have been lodged with the company within the time limit as prescribed by sub-section (1-A), the lodgement is a good delivery. Any delay on the part of the company in actually effecting the transfer is immaterial. A registration effected by the company after a delay of ten years was held to be not hit by any of the provisions of the Companies Act. *Mahabir Singh v. Jai Singh,* (1978) 48 Com Cases 558 at 562 (Del).

Bulk lodgement of instrument(s) of transfer of shares/debentures

Department's Circular.—As per the existing procedure prescribed under section 108 of the Companies Act, 1956, the shares/debentures can be transferred only by execution of a transfer deed. In case of bulk handling of transfer deeds, in respect of transactions entered into by the Foreign Institutional Investors (FIIs) registered with SEBI, Public Financial Institutions as defined under section 4A of the Companies Act, 1956 and Mutual Funds (domestic and off-shore), there is a considerable amount of difficulty in complying with the existing procedure of signing each individual instrument of transfer which may number in thousands, particularly when the transferee is the same. With a view to overcoming these difficulties and simplifying the procedure, the companies are advised to accept transfer deeds executed in such cases in the manner specified below:—

(*i*) In respect of bulk transfers where there is a single transferee, the transferee, instead of signing each transfer deed, may fill up and sign a covering transfer deed in the existing prescribed format complete in all respects, enclosing therewith all the related transfer deeds in the prescribed format duly executed by transferors.

(*ii*) The covering transfer deed shall contain, by way of an Annexure, details of distinctive numbers and corresponding certificate numbers of shares / debentures involved in transfer.

(*iii*) The part relating to 'transferee's particulars' in the individual transfer deeds (enclosed with the covering transfer deed) need not be signed by the transferee and may be merely stamped with the name and address of the transferee.

(*iv*) Requisite amount of stamps may be affixed on the covering transfer deed or paid in a manner as otherwise prescribed by the Government.

2. You are requested to bring the above to the notice of your constituent member companies for necessary action.' [*Department's Circular No.* 15, dated 28-12-1993].

Transfer when complete

A transfer is complete as between the transferor and transferee when all the formalities such as execution of the transfer deed and handing over the share certificates are complete. *CIT v. Ramaswamy,* (1985) 57 Com Cases 7, 10 (Mad); *Madanlal Patodia v. Lakshminarayan Cotton Mills Ltd.,* (1978) 48 Com Cases 747, 756 (Cal); *P.J. Thakar v. V.R. Shelat,* (1973) 43 Com Cases 203, 210 (Guj) (**reversed** on another point in *Ramachandra Shelat v. Pranlal Jayanand Thakar,* (1975) 45 Com Cases 43 : AIR 1974 SC 1728); *Rose v. IRC,* (1952) 1 All ER 1217; *Mathalone (R.) v. Bombay Life Assurance Co. Ltd.,* (1954) 24 Com Cases 1 : AIR 1953 SC 385; *A.M.P. Arunachalam v. A.R.*

Krishnamurthy, (1979) 49 Com Cases 662 (Mad); *Killick Nixon Ltd. v. Dhanraj Mills Pvt. Ltd.,* (1983) 54 Com Cases 432 (Bom); *Surjit Malhan and B. K. Malhan v. John Tinson and Co.,* ILR (1985) HP 135 at pp. 164 to 167 (HP); *Gammon India Ltd., Re,* (1990) 3 Comp LJ 89 (CLB). Where a member actually gave a transferee a signed transfer form, the court said that it seemed rational and business like to say that the member had transferred the shares to the transferee. That was what the transfer form meant. Whether the transferee was actually registered in the company's books was not the transferor's concern. The transfer was in violation of preemptive provisions. *Hurst v. Crampton Bros. (Cooper) Ltd.,* (2003) 1 BCLC 304 (Ch D). The court **followed** : *Safeguard Industrial Investments Ltd. v. National Westminster Bank Ltd.* [1982] 1 All ER 449, [1982] 1 WLR 589 distinguished. *Re Marco (Ipswich) Ltd.* [1994] 2 BCLC 354.

Where certain transfers were registered on the basis of incomplete papers, the court directed the register of members to be rectified and papers returned to the person to whom they belonged. *Surjeet Malhan v. John Tinson & Co.,* (1998) 92 Com Cases 631 : (2000) 6 Comp LJ 360 (AP).

In *Life Insurance Corporation of India v. Escorts Ltd.,* (1986) 59 Com Cases 548 at 618 : AIR 1986 SC 1370, the Supreme Court held that "a transfer effective between transferor and the transferee is not effective as against the company and any person without notice of the transfer until the transfer is registered in the company's register". So long as his name is not registered, the transferee has not the perfected right of property which he would have if he had been the registered holder of the shares. The company is entitled to deal with the shareholder who is on the register. *Maneckji v. Wadilal,* AIR 1926 PC 38. The matter has been very succinctly put by EVE, J., in the case of *In re, Copal Varnish Co. Ltd.,* (1917) 2 Ch 349 at p. 354 in the following terms: "The operation of legally transferring a share is indeed one of some complexity. In the first place there is the contract of sale followed by the execution of an instrument of transfer containing an agreement by the purchaser to accept the shares subject to the several conditions on which the vendor held the same immediately prior to the execution of the transfer—that is to say, subject, amongst other things, to the conditions imposing restrictions on the vendor's right to transfer to that particular purchaser. Up to this point all that has been done is to pass an equitable interest in the shares to the transferee. There has been no legal assignment completed; indeed, the most crucial point in the transaction has not been reached—the acceptance of the transfer by the Board of directors and the passing of it for registration; and even then the matter is not completed, because until the actual entry of the name of the transferee on the register, the transferor remains the legal holder of the share."

The transferee gets the legal and equitable rights to get his name substituted in the company's register of members and this right cannot be defeated by the transferor or any person claiming under him. *Fazal D. Allana v. Mangaldas M. Pakvasa,* AIR 1918 Bom 303.

Transfer when effectual between company and transferees

The fundamentals of this subject have been thus summarised by RADHAKRISHNA MENNON J in *Mathrubhumi Printing and Publishing Co. Ltd. v. Vardhman Publishers Ltd.,* (1992) 73 Com Cases 80, 102 (Ker): "The question, therefore, is: when would the transfer become effectual as between the company and the transferees? The deed of transfer shall not have any effect so as to put the transferee into the position of the transferor until it has been lodged with the company, and it must be not only lodged, but accepted by the company as properly lodged, because if the company finds that it does not comply with the provisions of the Act it is its duty to refuse to receive it, (see the decision of the Chancery Division in *Nanney v. Morgan,* (1888) 37 Ch 346). Until the lodgment, the transfer may be effective between the transferor and the transferee. The transfer, however, becomes complete and the transferee becomes a shareholder in the true and full sense of the term with all the rights of a shareholder, only when the transfer is registered

in the company's register. In the same strain (*sic*) is the statutory mandate to the company discernible from section 108 not to register the transfer of shares unless a proper instrument of transfer duly stamped and executed is delivered to the company. Until such time as registration is granted, the person whose name is found in the register alone need be treated as the shareholder by the company. During the interregnum, that is, from the date of the transfer till the date of lodgment the transferee no doubt, becomes the owner of the beneficial interest though the legal title continues with the transferor. This antecedent right in the transferee is enforceable, so long as no obstacle to it is shown to exist in any of the articles of association of a company or a person with a superior right or title, legal or equitable, does not appear to be there. This in brief is the law stated by the Supreme Court in the decision in *Pranlal's* case, (1975) 45 Com Cases 43 : AIR 1974 SC 1728 and *Escort's* case, (1986) 59 Com Cases 548 : AIR 1986 SC 1370. The principles deducible from the above judicial pronouncements can be stated thus: Until the transfer of the shares is actually registered it should be held that the transferee's title to the share is inchoate, and that the legal title remains vested in the transferor (see *Colonial Bank v. Hepworth,* (1887) 36 Ch D 36 at page 54). This line of reasoning is reinforced by article 19 of Table A of Schedule I to the Act which provides that until the name of the transferee is entered in the register of members, the transferor shall be deemed to remain the holder of the shares transferred, thereby clearly stating that the legal title remains vested in the transferor. It is true that delay in the registration involves danger to the transferee if some already existing prior equity may come to light, as in the case in *Ireland v. Hart,* (1902) 1 Ch 522, where a husband mortgaged shares of which he was trustee for his wife and, before the mortgagee had become the registered holder of the shares, the wife took proceedings claiming that her equitable title prevailed over that of the mortgagee, a claim which the court upheld; or a second transfer may be passed and registered and thus the first transfer may be defeated (see para 39.07 of PALMER'S COMPANY LAW, 23rd Edn., 1982) [now para 40-08, 24th Edn., 1987: para 6.605, Vol. 1, 25th Edn., 1992]. The position has been illustrated by PALMER thus:

"The rule on this point is that, as between two persons claiming title to shares in a company like this, which are registered in the name of a third party, priority of title (*i.e.*, equitable title) prevails, unless the claimant second in point of time can show that as between himself and the company, before the company received notice of the claim of the first claimant, he, the second claimant, has acquired the full status of a shareholder; or at any rate that all formalities have been complied with, and that nothing more than some purely ministerial act remains to be done by the company, which as between the company and the second claimant the company could not have refused to do forthwith; so that as between himself and the company he may be said to have acquired, in the words of LORD SELBORNE, 'a present, absolute, unconditional right to have the transfer registered, before the company was informed of the existence of a better title'."

"It, therefore, follows that the equitable right of the transferee gets metamorphosed into the absolute right of a shareholder only when the names of the transferees after the recognition of the transfer, are entered on the register. This can be viewed from another angle and it is this: when once the transferee does everything that he is required to do under law, to get his name entered on the register by proper lodgement of the instruments of transfer and no other obstacles remain in enforcement of the said right, the transfer becomes effective as against the company also. Thereafter, the company cannot unilaterally alter its articles affecting the aforesaid right of the transferee. Mere delay in the actual registration of the name of the transferee on the register provided there is a proper lodgement of the instrument of transfer cannot affect the above right of the transferee. If that be the position, the right of the transferee to get his name entered on the register gets crystallised when proper lodgement is effected and the transfer from the date of the proper lodgement becomes effective as against the company also, and such rights cannot be affected by subsequent actions of the company like amendment of articles, *etc.* Subject to what is stated above, the transfer, once the company after recognising the transfer en-

ters the name on the register, relates back to the time when the transfer was first made (see *Howrah Trading Co. Ltd. v. CIT,* (1959) 29 Com Cases 282; AIR 1959 SC 775)".

A transfer of shares becomes fully efficious the moment the transfer documents are completed, executed and handed over. What remains thereafter is mutation of the name of the buyer on the company's register of members. This is an act of clerical nature and can be attained by complying with the procedure prescribed by the Companies Act and the particular company's articles. *Molins Overseas Holdings Ltd. v. MOI Engineering Ltd.,* (1995) 5 Comp LJ 341 (CLB—New Delhi).

Transfer by way of gift, when complete.—A shareholder, who was holding all the bearer shares in a company, died leaving behind the shares in the hands of his widow. She became the holder because the shares were bearer and she had the share certificate with her. Another person claimed that the sole director of the company had, before the death of the original shareholder and on his oral instruction, passed a resolution under which the bearer shares were cancelled and an equal number of registered shares were issued to the claimant as a gift. But the bearer share certificate was not transferred to the company as required by the company's articles. The court held that the articles of association had to be read in light of the International Business Companies Act, s. 31, which stipulated that a bearer share certificate had to be delivered up for cancellation prior to the issue and registration of registered shares. On the facts, claimant had failed to show that the deceased shareholder had done all the acts necessary to transfer the shares to him and, therefore the gift was not complete. *De Villalba v. Adex International Ltd.,* (1999-2000) 2 I.T.E.L.R. 624, Benj H.C. (BVI). The court followed : *Choithram International SAT v. Pagarani,* (1998) 2 O.F.L.R. 1.

Effect of mere agreement to transfer

A mere agreement to sell shares does not deprive a member from exercising his rights as a member. The company can take cognizance of the transfer only when the transfer instrument alongwith share scrips are lodged with the company. *Martin Castelino v. Alpha Omega Ship Management P. Ltd.,* (2001) 104 Com Cases 687 : (2001) 41 CLA 271 : (2001) 33 SCL 210 (CLB—PB).

Transfer relates back to the date of execution

A transfer, when accepted, relates back to the date of execution of the instrument. *Killick Nixon Ltd. v. Dhanraj Mills Pvt. Ltd.,* (1983) 54 Com Cases 432 (DB) (Bom). See also *CWT West Bengal v. Sumitra Devi Jalan (Smt.),* (1974) 96 ITR 35 (Cal).

Effects of transfer

Once a transfer form has been executed, the transfer is complete as between the transferor and the transferee and the transferee acquires the right to have his name entered in the register of members. Apart from lodging the completed transfer form with the company, no further application is necessary for having the name of the transferee entered in the register of members. By getting his name entered in the register of members, the transferee perfects his title to the share. As a result of the transferee becoming a member of the company, a contractual relationship arises between the company and the transferee by virtue of S. 36 with the Articles of Association of the Company constituting the terms of the contract between the parties, but this 'statutory' contract has nothing to do with the transfer of shares. *Killick Nixon Ltd. v. Dhanraj Mills Pvt. Ltd.,* (1983) 54 Com Cases 432 (Bom–DB); *Gammon India Ltd., Re,* (1990) 3 Comp LJ 89 (CLB). A transferee of shares, as much as a goods, gets no better title to them than his transferor. *Fazal D. Allana v. Mangaldas,* AIR 1918 Bom 303.

A transfer to a firm in the firm name, if accepted by the company and registered, will make the partners individually liable as members. *Land Credit Co. of Ireland, Re, Weikersheim's* case, (1873) 8 Ch App 831.

A company cannot refuse to register a transfer on the ground that the transfer was without consideration or that there was collusion and connivance between the transferor and transferee. Any objection about inadequate consideration can be raised only by the transferor himself and not by the company particularly where the shares are fully paid. Where the transfer is a spot delivery contract, S. 108 is not applicable. *Sanatan Investment Co. Pvt. Ltd. v. Prem Chand Jute Mills Ltd.*, (1983) 54 Com Cases 186 (Cal).

§ See also Notes under this section under the heading "Transfer when effectual between Company and transferees".

Blank transfers

What is blank transfer.—In the case of a blank transfer the seller only fills in his name and signature. Neither the buyer's name and signature nor the date of sale are filled in the transfer form. The advantage in giving such a blank deed is that the buyer will be at liberty to sell it again without filling his name and signature to a subsequent buyer. In the latter case he can avoid the payment for the transfer stamp and new deed to the buyer. The process of purchase and sale can be repeated any number of times with the blank deed and ultimately when it reaches the hands of one who wants to retain the shares he can fill in his name and date and get it registered in the company's books. For this ultimate transfer and registration, the first seller will be treated as the transferor even if it happens years after his death. (Thomas Committee Report quoted with approval by the Vivian Bose Commission in their *Report*, pages 799-800).

Pursuant to the recommendation of the Vivian Bose Commission of Inquiry regarding the imposition of restrictions on the period of currency of blank transfers of shares, necessary statutory provisions were made in section of the Companies Act, 1956 by an amendment carried out by section 13 of the Amendment Act, 1965 XXXI of 1965. The provisions of the Act so amended were brought into force with effect from 1-4-1966. Immediately thereafter, doubts arose as to whether the new provisions would in effect completely prohibit the system of blank transfers or only place restrictions on the period of currency of the same. In order to remove this doubt, it has considered necessary to clarify that the intention of the legislature was only to place restrictions on the period of currency of such transfers and not to prohibit the system as such. Such a clarification was necessary in order to ensure the smooth functioning of the stock exchanges and the capital market. *Extract from Eleventh Annual Report*—Year ended March 31, 1967.

Blank transfers are common, not only in cases of sales of shares but also where shares are offered as security by way of mortgage and otherwise. The characteristic feature of a blank transfer is that the transfer instrument is signed only by the transferor, the name and signature of the transferee being left blank, and then delivered to the transferee along with the certificate of the shares so that the transferee or any other person to whom in his turn he may pass it on, may fill up the blank and complete the instrument by putting his name and signature and apply to the company for registration of the transfer in his name as holder of the shares.

The advantage of this is that it saves the trouble of complying with the formalities of transfer every time the right to the shares is passed from hand to hand and it also saves the payment of stamp duty on each successive transfer.

A transfer in blank, when accompanied by the share certificate or scrip carries to the transferee both the legal and equitable right in the shares and also the right to call upon the company to register the transfer. In the words of LORD WATSON, "the person to whom it *i.e.*, the blank transfer along with the certificate is delivered, can effectually transfer his interest by handing his certificate to another, and the document may thus pass from hand to hand until it comes into the possession of a holder who thinks fit to insert his own name as transferee, and to present the document to the company for the purpose of having his name entered in the register of shareholders and obtaining a new certificate in his own favour". *Colonial Bank v. Cady*, (1890) 15 App Cases 267 at 277. A blank transfer passes not the property in shares but both legal and equitable title in the shares to the holders

without the risk of his right being defeated by the original registered shareholder or any other person deriving rights from such registered shareholder. *Fazal D. Allana v. Mangaldas M. Pakvasa,* (1921) 23 Bom LR 1144 : AIR 1922 Bom 303.

The important point to be noted here is that the share certificate should also be delivered along with the blank transfer.

In all cases only a *bona fide* holder will have the right to fill in his name or the name of a person for whom he is acting under an authority and apply for registration of the transfer. *Colonial Bank v. Hepworth,* (1887) 36 Ch D 36. Where share scrips accompanied by duly executed transfer forms came into the hands of a *bona fide* purchaser, it was held that the original owner who signed in blank was estopped from questioning the validity of the title of the *bona fide* purchaser. *Sumitra Debi Jalan v. Satya Narayan Prahladka,* AIR 1965 Cal 355.

Where in the course of a transaction the brokers acted as the shareholder's agent to make representations to the third parties that they (the brokers) had the authority of the person to transfer the shares and receive purchase price, that person could not plead that the brokers had obtained the share certificates by cheating him. *Fazal D. Allanna v. Mangaldas M. Pakvasa,* (1921) 23 Bom LR 1144 : AIR 1922 Bom 303.

In *Howrah Trading Co. Ltd. v. CIT.,* (1959) 29 Com Cases 282 : AIR 1959 SC 775, the Supreme Court recognised the validity of "blank transfers" *viz.*, where the name of transferor is entered and the transferor signs the transfer with the share scrip annexed, and hands it over to the transferee who, if he chooses, may complete the transfer by entering his name and then apply to the company to register his name in the place of that of the transferor. It is not necessary that the price should have been fixed at that very time. The price may be fixed by the party subsequently by their own consent or by an agreed method failing which reasonable formula will apply and reasonable price means the price that the shares would fetch at the time of the transfer and not their face value. *Union of India v. Kulu Valley Transport Ltd.,* (1958) 28 Com Cases 29 (P&H). It was also held in this case that if the proposal of sale is made by the joint owner by their separate letters, a communication of acceptance to one of them only was not binding on the other.

After the amendment of the section by the insertion of sub-sections (1-A), (1-B), (1-C) and (1-D), as further amended by the Amendment Act of 1988, the scope for transfers in blank is considerably restricted.

For a discussion of the subject of blank transfers, in their several aspects, see *Arjun Prasad v. Central Bank of India,* AIR 1956 Pat 32.

Effect of transferor's death in case of blank transfer.—The question whether a blank transfer can be completed by the transferee by inserting his name and signature and presented to the company for registration after the death of the transferor was considered in an appeal before the Company Law Board under section 111 (Appeal No. 40 of 1971), *Canara Bank v. Mysore Cement Company Ltd. and MR. P.B.* MENON of the Board, following the decision in *Bengal Silk Mills Ltd.,* (1942) 12 Com Cases 206 : AIR 1942 Cal 461, has correctly expressed the view that a blank transfer instrument can be completed by filling the name and signature of the transferee even after the death of the transferor, and the company cannot refuse to register the transfer on the ground that the signing by the transferee after the death of the transferor would not be valid. In this connection, the point to be noted is that, as LORD WATSON pointed out in *Colonial Bank v. Cady,* (1890) 15 App Cas 267 where a transferor delivers a blank transfer along with the certificate of the shares, he thereby transmits to the transferee both his legal and equitable title to the shares. After parting with his title he is not further concerned with the shares.

Where a blank transfer cannot be given effect to for any reason, probably a suit for specific performance will have to be brought, unless the lawful heirs of the transferor consent to the transfer, and if the company so requires, execute a fresh instrument of transfer. See also section 109.

Gift of shares under blank transfer.—Where shares in blank transfer forms signed by the transferor are gifted to a donee and the share certificate relating thereto are also handed over along with it, the transfer will be complete on signing the form as transferee; and the death of the transferor subsequent to his signing and handing over the blank transfer form and the share certificate will not affect its validity. The Supreme Court pointed out that a donee of shares cannot exercise the rights of a shareholder *vis-a-vis* the company unless the transfer is registered with the company. *Vasudev Ramachandra Shelat v. Pranlal Jayanand Thakar,* (1975) 45 Com Cases 43 : AIR 1974 SC 1728 **reversing** *P.J. Thakar v. V.R. Shelat,* (1973) 43 Com Cases 203 (Guj). In a Calcutta case, *Sheila Devi Chamria v. Tara Chand Saraogi,* (1986) 60 Com Cases 735 (Cal) (DB) a suit was filed for a declaration that the plaintiff was the owner of 900 equity shares of the company and for a decree directing the company to register the transfer. The shares came to the plaintiff as a gift along with blank transfer form duly signed by the transferor. The plaintiff also proved that she was getting the entire amount of dividends since the execution of the gift deed. It was held that the gift was complete. The company had no reason to deny the claim of the plaintiff for registration of the shares in her name. It might have been the wish of the transferor not to register the transfer during his lifetime. But that would make no difference to her rights.

The principles of these authorities were not applied in a situation where blank transfer forms were handed over not by the owner herself or under her signature but by her husband without her authority. *John Tinson & Co. P. Ltd. v. Surjeet Malhan (Mrs.),* (1997) 88 Com Cases 750 : AIR 1997 SC 1411 (SC). The circumstances of the transaction in this case also amounted to a gift because only one rupee was taken as a token consideration for a large number of shares.

§ See also Notes under the heading "Transfer by way of gift" *post.*

Restrictions on blank transfers of shares—Procedure Clarified by Department

Department's Clarification.—Section 13 of the Companies (Amendment) Act, 1965 which seeks to impose restrictions on the period of currency of blank transfers of shares, comes into force today, April 1, 1966.

The Notification amending the Companies (Central Government's) General Rules and Forms, 1956, whereby a transfer form has been prescribed was published in the Gazette of India Extraordinary dated the 18th March, 1966. The transfer form is required to be presented to the Registrar of Companies before it is signed by or on behalf of the transferor so that the former may stamp or otherwise endorse thereon the date on which it is so presented.

While presenting the transfer form to the Registrar, the first four columns in regard to the name of the Company, description of shares, name of the stock exchange, if any, where the shares are dealt in or quoted on and the name of the transferor in full should be filled in full. The other columns of the form need not be filled in. (*Press Note,* dated 21st April, 1966).

Closure of register of members

The Department of Company Affairs is of the view that the fixation of a record date for the purpose of the AGM or declaration of dividends amounts to closure of the register of members for the purpose of section 108(1A). There cannot be any fixation of record date without closure of register of members. [*Circular No.* 8/4(108)/67-CL-V, dated 4-8-1967]. Closure of "register of members" should not be taken in the literal sense, but in the accounting sense. In the latter sense, closure means freezing of balances as on a particular date. Closure of register of members has to follow the provisions of section 154. Further, in case of listed companies, the requirements of the stock exchange also need to be taken care of.

Fixing a 'record date' without closing register of members

Department's Clarification.—The action of the company in fixing a "record date" without seeming to close the register of members has no legal validity. If by naming a "record date" the company intends that any proposal for transfer of shares received by the company between the "record date" and the date of the (annual general) meeting at which dividends are declared would not be considered or would be held in abeyance, then, this would amount to closing the register of members on and from the "record

date". The effect of the provisions of section 108(1A) of the Companies Act in such a case will have to be considered in the above light. (*Circular No.* 8/4(108)/67-CL-V, dated 4-8-67.)

Death of transferor or transferee before registration of transfer

Where the transferor dies and the company has no notice of his death, registration of the transfer will not be irregular. But if the company has notice of his death, the proper course is not to register until his legal personal representative or representatives are referred to.

Where the transferee dies and company has notice of his death, a transfer of shares cannot be registered in the name of the deceased. With the consent of the transferor and the legal personal representatives of the transferee, the transfer may be registered in the names of the latter. But if there is a dispute, an order of Court will have to be insisted upon.

The company is not bound to conduct an enquiry as to whether the transferee is alive on the date the transfer is accepted by the company or whether he is capable of entering into a valid contract on that date. The company would be perfectly justified in acting on the basis that what is contained in the transfer deed is true. *Killick Nixon Ltd. v. Dhanraj Mills Pvt. Ltd.*, (*Supra*).

Transfer by representative

Where a transfer is executed by a person in a representative capacity such as an officer of a company or other corporate body or by an attorney or a liquidator or administrator, executor, trustees, *etc.*, the authority under which the transfer is executed or a certified or authenticated copy or other proof of the authority, must be produced, before the transfer can be registered.

Transfer without authority of owner.—Shares in a company can be transferred either by registered owner or by any one else with his authority. A sale by any unauthorised person will be void. Accordingly the Supreme Court held that, transfer of shares by the husband of the lady owner without her authority was void and the transferee obtained no rights. *John Tinson & Co. P. Ltd. v. Surjeet Malhan (Mrs.).* (1997) 88 Com Cases 750 : AIR 1997 SC 1411.

Forged transfers

A forged transfer can pass no title and is void. This is so even where a person acting innocently has taken a transfer of shares, with the transferor's signature forged, and has got himself registered as a member in the transferor's place and has received a share certificate in his own name. *Simm v. Anglo-American Telegraph Co.*, (1879) 5 QBD 188 (CA); *France v. Clark*, (1884) 26 Ch D 257 (CA); *Barton v. London and North Western Rly. Co.*, (1888) 38 Ch D 144 at 149 (CA). The certificate can give him no title to the shares. On being shown of the forgery, the company is bound to restore to the register the name of the purported transferor and cancel that of the transferee, who is bound to surrender the certificate given to him and repay all dividends and other benefits received by him and also indemnify the company for all losses incurred by it by reason of the forged transfer. If, however, through his own negligence or conduct, the transferor had so acted as to induce the company to believe that the transfer was genuine, that would create an estoppel disentitling him to succeed, otherwise mere negligence on the part of the shareholder does not create an estoppel disentitling him to succeed. *Mayor Constables & Co. of Merchants of the Staple of England v. Governor & Co. of Bank of England*, (1887) 21 QBD 160 at 173, 174 (CA); *Cf. Swan v. North British Australasian Co.*, (1863) 2 H & C 175 Ex Ch. Failure to reply to an intimation by the company that the transfer is about to be made unless objected to is not negligence on the part of the shareholder. *Barton v. London and North Western Rly. Co.*, (1889) 24 QBD 77 (CA); *Welch v. Bank of England*, (1955) 1 All ER 811. The company is not estopped from disputing, as against the transferee, the validity of the transfer. *Waterhouse v. London and South Western Rly. Co.*, (1879) 41 LT 553; *Cf. Simm v. Anglo-American Telegraph Co.*, (1879) 5 QBD 188 (CA); *Balkis Consolidated Co. v. Tomkinson*, (1893) AC 396 at 412, 413 (HL) per LORD FIELD; *Dixon v. Kennaway & Co.*, (1900) 1 Ch 833. **Following** *Knights v. Wiffen*, (1870) LR 5

QB 660; *Platt v. Rowe (Trading as Chapman and Rowe) and C M Mitchell & Co.*, (1909) 26 TLR 49; *Cf. Foster v. Tyne Pontoon and Dry Docks Co. and Renwick*, (1893) 63 LJQB 50 at 55.

An estoppel may arise against the company where on the basis of a forged transfer the company has issued a certificate in favour of the transfer and he has acted on the faith of it to his detriment or he has transferred the shares to an innocent third party for consideration. See cases cited under 'Estoppel' as to title under S. 113. For the most authoritative and elaborate discussion on the subject of forged transfers, see *Sheffield Corporation v. Barclay*, (1905) AC 392 (HL).

In *Kaushalya Devi (Smt.) v. National Insulated Cable Company of India Ltd.*, 1977 Tax LR 1928 (Del) it was held that when shares were transferred by means of a forged transfer deed, the transferee did not get any right in respect of the shares. The fact that he was a *bona fide* purchaser for value would not make any difference. A forgery is a nullity. A person receiving shares under a forged instrument of transfer gets no rights. He is bound to return the scrips to the person to whom they rightfully belong. See also *Bahia and S.F. Railway Company, In Re*, (1868) LR 3 QB 584.

In such cases a company should either respect his membership and if it cannot do so and compels him to return the scrips, it would have to answer him in damages. See *Bloomenthal v. Ford*, (1897) AC 156 and the cases cited therein.

A person who sends in and procures registration of the transfer and the issue of a fresh certificate on the basis of a forged deed is bound to indemnify the company against the untoward consequences even if he acted in good faith. See *Welch v. Bank of England*, (1955) 1 All ER 811 and the cases cited therein. Such liability follows where *e.g.*, a stock broker, trusting his clients innocently forwarded forged document to the company. *Yeung v. Hongkong and Shanghai Banking Corpn.*, (1980) 2 All ER 599.

In case of joint shareholdings, a transfer to be effective must be executed by all and if the signature of any one be forged, the transfer will be void. *Nicol's* case, (1885) 9 Ch D 421. See also Notes under the heading "Joint Shareholders", *infra*.

Where the signature on the transfer form, being disputed, could not be proved to be that of the owner of the shares, the matter was over and the court refused to go into the further question of consequences of the fact that the transfer had not been stamped. *Elliot v. Hollies Ltd.*, (1998) 1 BCLC 627 (Ch D).

Liability for submitting false papers

A company and its share transfer agents were held liable to compensate the true owner of the shares whose shares were registered in the name of another person on the basis of duplicate share certificates. They could recover their indemnity amount from the share broker who had sent in false papers on the basis of which duplicates were issued. *Royal Bank of Scotland v. Sandstone Properties Ltd.*, (1998) 2 BCLC 429 (QBD).

Forgery or unauthorised transfer of uncertificated (dematerialised) shares

Dealing with this subject, an author observes as follows:

The risk of unauthorised transfers of uncertificated shares is allocated differently than the risk of unauthorised transfers of certificated shares. There are three differences.

The first is that the legal owner of certificated shares is not bound by transfers that have been forged by an employee or a broker whom he had entrusted with his share certificates. Under the new regime the legal owner is bound by an instruction sent by an employee or his broker *albeit* without his authority. This shifts the risk of unauthorised transfers away from the transferee and onto the legal owner. This movement is to be welcomed because risk is most efficiently carried by the person who is in the best position to control it. The legal owner of uncertificated shares is in the best position of all the parties involved to restrict access to his network connection point. Likewise, the sponsored CREST member is free to choose his sponsor and can thereby reduce the risk of his shares being transferred without his authority.

The second difference is that CREST Co. is liable for damages arising out of forged transfer instructions. This insulates the transferee to some extent against the risk of unauthorised transfers, but the protection given by the statutory rule is weaker than the effect created by estoppel. CREST is only liable up to £ 50,000 per incident, and it ceases to be liable if it identifies the forger.

The third difference is that although the estoppel rules may not have been abolished, it is not easy to see how they would operate against the issuing company. It is doubtful whether they will still provide a tool helping the transferee to claim an indemnity from the company in cases of unauthorised transfers. Of course, the company's liability was never based on technical points alone. It was supported by the idea that shares have been created to circulate in a fluid market. The law recognised this purpose and enhanced the transferability of shares by protecting the transferee. In *Davis v. The Bank of England,* (1824) 2 Bing 391 at 409 : 130 ER 357 at 363. BEST C.J. justified the liability of the issuer to the transferee for forged transfers in the following words:

"If this not be the law, who will purchase stock, or who can be certain that the stock which he holds belongs to him? It has ever been an object of the legislature to give facility to the transfer of shares in the public funds. This facility of transfer is one of the advantages belonging to this species of property and this advantage would be entirely destroyed if a purchaser should be required to look to the regularity of the transfers to all the various persons through whom such stock has passed." The principle on which the case was decided was later confirmed by *Coles v. The Bank of England,* (1839) 10 Ad. & E. 437 at 449, 113 E.R. 116 at 171 and *Sloman v. The Bank of England,* (1845) 14 Sim. 475 at 486; 60 ER 442 at 447; see also *Welch v. The Bank of England,* (1955) Ch. 508 at 530 per HARMAN J.

Prosecution for accepting forged transfer

If the directors knowingly accept a transfer which is forged they run the risk of being prosecuted. A complaint was filed against the officers of a company for cheating by accepting transfers on the basis of forged signature. The Magistrate took cognizance. The High Court refused to quash the proceedings. On appeal to the Supreme Court the proceedings were quashed. The court was of the view that allowing a criminal proceeding to continue even when the allegations in the complaint do not make out any offence would tantamount to an abuse of the process of the court. The allegations were of vague nature. Beyond an allegation of forgery of signature there was nothing to substantiate the bald allegation. There was no pin-pointing of the allegations against any particular officers of the company. *Ashok Chaturvedi v. Shitul H Chanchani,* (1998) 94 Com Cases 401: (1998) 4 Comp LJ 394 (SC).

Rights under unregistered transfer of shares

It must first be noted that, until the registration of the shares in his name the transferee cannot exercise any rights as shareholder in respect of the shares transferred in his name, as he does not become the legal holder until registration. In this connection, see *K.P. Jain v. S.K. Gupta,* (1978) 48 Com Cases 774 (Delhi). **Reversed** on another point in *S.K. Gupta v. K.P. Jain,* (1979) 49 Com Cases 342 : AIR 1979 SC 734. See also, *Hindustan Investment Corporation v. CIT,* (1955) 25 Com Cases 57, 66 (Cal); *Jayahind Industries Ltd. v. CIT,* (1986) 60 Com Cases 950, 953 (Bom).

In *Killick Nixon Ltd. v. Bank of India,* (1985) 57 Com Cases 831 (Bom), the court held that the transferee of shares whose name is not registered in the register of members can only exercise the rights of a member of the company through the transferor who is his constructive trustee. The transferor who remains the member of the company is bound to comply with all reasonable directions of the transferee with respect to the rights attached to the shares, such as voting according to the directions of the transferee. Where a debenture was sold but not registered with the company, transferor remained the owner and therefore it was held that the inclusion of his name in the company's return as to allotment was proper. *Basant Company v. Benaras Cotton and Silk Mills Ltd.,* (1964) 34 Com Cases 394 (All—DB). See also *Life Insurance Corporation of India v. Escorts Ltd.,* (1986) 59 Com Cases 548 : AIR 1986 SC 1370; *Amraoti Electric Supply Co. v. Chandak,* (1954) 24 Com Cases 465, 468 (Nag). He is not, however, bound to spend his own funds for acquiring rights shares on behalf of the transferee. *Mathalone R. v. Bombay Life Assurance Co. Ltd.,* (1954) 24 Com Cases 1 : AIR 1953 SC 385.

Where shares are transferred whether under a regular instrument or in blank transfe form, but the transfer is not registered either because the company has refused to registe or the transfer deed has not yet been delivered to it, the rights of the transferor and trans feree in respect of the shares are thus summarised:—

"In *Howrah Trading Co. Ltd. v. CIT,* (1959) 29 Com Cases 282 : AIR 1959 SC 775 the Supreme Court has held that the transferee of shares transferred by way of blank transfer does not have the benefit of a legal title until his name is entered in the register o members, although the completion of the transaction by having the name entered in the register of members relates it back to the time when the transfer is made. During the pe riod that the transfer exists between the transferor and the transferee without emerging as a binding document upon the company, equities exist between them, but not between the transferee and the company. The transferee can call upon the transferor to attend the meeting, vote according to his directions, sign documents in relation to the issuance of fresh capital, call for emergent meetings, and *inter alia* also compel the transferor to pay such dividend as he may have received. But these rights, though they, no doubt, clothe the transferee with an equitable ownership, are not sufficient to make the transferor a full owner, since the legal interest *vis-a-vis* the company still outstands in the name of the transferor so much so that the company credits the dividends only to the transferor and also calls upon him to make payment of any unpaid capital, which may be needed. It was further laid down that a person who has purchased shares in a company under a blank transfer and in whose name the shares have not been registered in the books of the company is not a "shareholder" in respect of such shares within the meaning of section 18(5) of the Income-tax Act, notwithstanding his equitable right to the dividend on such shares". *Kidambi Vatapatra Sayi v. Vupputuri Venkata Punnayya,* (1965) 1 Comp LJ 257 (AP) (DB). See also *Travancore Electro Chemical Industries Ltd. v. Alagappa Textiles (Cochin) Ltd.,* 1972 Tax LR 2192 (Ker); *Shree Shakthi Mills Ltd. v. CIT,* (1948) 18 Com Cases 169, 172 (Bom); *Jaluram Bhikulal v. CIT, M.P.,* (1953) 23 Com Cases 103 : AIR 1953 Nag 77; *Jagajit Singh Industries v. Shivram Batha,* (1962) 32 Com Cases 117 (Punj). While **following** *R. Mathalone v. Bombay Life Assurance Co. Ltd.,* (1954) 24 Com Cases 1 (SC), the Calcutta High Court held that the principle by which a trustee is bound to his *cestui que* trust cannot be extended to cases where the transferee had not taken active steps to get his name included as a member in the register of the company with the due deligence and meanwhile certain other privileges or opportunities arise from the shares under transfer. *Pradip Kumar Sarkar v. Luxmi Tea Co. Ltd.,* (1990) 67 Com Cases 491, 509 (Cal).

Note: All these decisions are now subject to provisions of section 206A inserted by Companies (Amendment) Act, 1988. See Notes under that section.

Effect of purchaser's default in payment upon rights of transferor

In *JRRT (Investments) Ltd. v. Haycraft,* (1993) BCLC 401 (Ch D); *Haycraft v. JRRT,* (1993) BCLC 401 (Ch D) the court stated the law on this point. Under the general law an unpaid vendor of shares has the right to exercise voting rights in respect of shares which remained registered in his name and he is free from any obligation to comply with the directions of the purchaser. The terms of a contract of sale cannot be taken to deprive him of his valuable rights, the right to dividend and the right to vote even where the purchaser has failed to make payment by or before the option completion date. There is a presumption that the parties could not have intended that the party committing default could go on enjoying benefits under the contract. Such a right on the part of the vendor was earlier recognised in *Musselwhite v. C H Musselwhite & Son Ltd.,* (1962) 1 All ER 201; *Siemmens Bros. & Co. Ltd. v. Burns,* (1918) 2 Ch 324.

Retention of title by seller till full payment

In an agreement for sale of shares, the price was payable by instalments. There was an escrow clause, *i.e.*, if the buyer defaulted in payment, the vendor was entitled to recover back the shares and also retain half the price paid on account. This was held not to be a penalty clause. It was valid and enforceable. The seller retained legal title to the shares until the buyer discharged the payment obligations. The escrow clause merely confirmed the vendor's right to rescind the contract for breach by the purchaser of an essential term. The court would relieve the party against a clause which empowers the seller to take back the shares and also to forfeit half the price only if the court was satisfied that the forfeiture would be penal and it would be unconscionable for the vendor to enforce it. It was not so in this case because the purchaser had enjoyed by virtue of those shares the position of being the chairman of the club for two years. *Else (1982) Ltd. v. Parkland Holdings Ltd.*, (1994) 1 BCLC 130 (CA).

Position of transferor after transfer

When a transferor makes a transfer, he makes an implied representation that the transfer will be registered by the company in the name of the transferee in the place of the transferor. If the company refuses to register the transfer for no fault or default of the transferee, the transferor, by reason of the shares continuing to stand in his name, will, in cases where he has received consideration for the transfer, be treated as trustee for the transferee and bound to act in accordance with his directions and for his benefit in respect of the shares, unless the transferee rescinds the contract and seeks to recover his money on a consideration which has failed. However, after the transfer form has been executed the transferor cannot be compelled to undertake any additional financial burden in respect of the shares at the instance of the transferee where, after the transfer of shares, but before the company had registered the transfer, the company offered rights shares to its members. The Supreme Court held that the transferor could not be compelled by the transferee to take up on his behalf the rights shares offered to the transferor. *Mathalone (R.) v. Bombay Life Insurance Co. Ltd.*, AIR 1953 SC 385 : (1954) 24 Com Cases 1. See also *Life Insurance Corporation of India v. Escorts Ltd.*, (1986) 59 Com Cases 548 : AIR 1986 SC 1370; *D.I. Lal v. S. Ganguli*, (1990) 68 Com Cases 576 at 579 (Del); *Pingle Venkat Rama Reddy v. Padampat Singhania*, AIR 1950 Bom 76; *K.N. Narayanan v. ITO, C Ward*, (1984) 55 Com Cases 182 (Ker). But where, due to the transferee's own laches, neglect or default, the transfer of the shares is not registered or where the transferee for reasons, not due to the transferor, does not apply for registration of the transfer, to the company, it is not possible to conceive how in law or equity the transferor can be held to be trustee for the defaulting transferee simply because the share continues to remain in the transferor's name in the books of the company.

A company did not accept a transfer of shares and continue to deal with the transferor in all matters including dividend payment. Subsequently the company brought an action to restrain the transferor company from exercising its rights in respect of the transferred shares and for appointment of a receiver in respect of those shares. It was held that the company's case was not maintainable. *Chogule Matrix Hobs Ltd. v. Chowgule and Co. (Hind) P. Ltd.*, 2000 CLC 1830 : (2000) 39 CLA 288 (AP).

An agreement for the sale of a share does not bind the seller to procure the registration of the transfer. His duty is performed when he hands over to the transferee a duly executed transfer. *Skinner v. City of London Marine Insurance Corpn.*, (1885) 14 QBD 882; *London Founder's Asson. v. Clarke*, (1888) 20 QBD 576 (CA).

Where a transferor transfers his share for consideration and delivers along with the share certificate the transfer form duly signed by him, but the transferee, instead of completing the transfer by signing his own name as transferee and presenting it for registration to the company, chooses to keep the transfer in blank and passes it on to others along with the share certificate, it cannot be said that the transferor, simply because the share continues to stand in his name, should be treated as a trustee for and be at the beck and

call of one or the other of a series of unknown holders of the blank transfer. When he sold his share to the original transferee he could not be deemed to have represented to the transferee anything more than that the share was transferable nor to have agreed to the transferee keeping or passing on the transfer in blank from hand to hand for an indefinite duration, without its being presented to the company for registration.

Transfer of ownership in shares is an independent and anterior requirement to the requirement of registration. Registration can be applied for only after the ownership in the shares has been transferred. *Subba Naidu (R.) v. C.G.T.,* (1969) 39 Com Cases 766 (Mad).

Where a shareholder executes a blank transfer to enable another to deal with the shares, he is bound not to do anything to obstruct registration of the transfer and if he improperly intervenes he is liable in damages, *Hooper v. Herts,* (1906) 1 Ch 549 (CA).

Transferor's liability for calls after transfer.—When shares are transferred, there arises an implied promise by the transferee to indemnify the transferor against all calls that may be made after the transfer. Such a promise to indemnify can be implied even in the case of blank transfers. *Ashworth Partington & Co.,* (1925) 1 K B 589, **per contra** *Hunble v. Langston,* 151 ER 871.

Dividends, bonus and rights issue.—A transferee of shares in a company whose name has not yet been entered in the company's register is not entitled to claim that dividends should be paid over to him, even though the transfer was prior in date to the declaration of the dividends in question, provided there was no unreasonable delay on the part of the company in registering the transfer. *Sonewala v. Lahore Electric Supply Co. Ltd.,* (1935) 5 Com Cases 357 at 358 (Lah). Where the transferor, by reason of the shares standing in his name, has received after the transfer, any dividend, bonus or other benefit accruing in respect of the share, the transferee being the person lawfully entitled thereto, can recover the same from the transferor, provided that he has not allowed his claim to become time-barred under the provisions of the Limitation Act, 1963. *Black v. Homersham,* (1841-80) All ER Rep 207; *In Re, Wimbush, Richards v. Wimbush,* (1940) 10 Com Cases 294 : (1940) 1 All ER 229 (CA); *Stewart v. Lupton,* (1874) 22 WR 855; *Rooney v. Stanton,* (1900) 17 TLR 28 (CA) (issue of new shares); *Chunnilal Khushaldas Patel v. H. K. Advijayaraju,* (1956) 26 Com Cases 168 : AIR 1956 SC 655 (transferee's right to dividend); *Vikas Jalan v. Hyderabad Industries Ltd.,* (1997) 88 Com Cases 551 (CLB) (Bonus Shares received by transferor, liability to handover to transferee).

Note : All these decisions are now subject to provisions of section 206A inserted by the Companies Amendment Act, 1988. See Notes under that section.

Dividend already paid to transferee.—Where the transfers in question were already registered and dividends paid to the transferee and subsequently the register was rectified by removing the transferee's name from the register on the ground of a technical nature, like inadequacy or non-cancellation of stamps, it was held that the transferee was not bound to handover the dividend amount to the transferor. The transferor had received a full consideration and for that reason even otherwise the transferee was better entitled to the dividend amount. *Kothari Industrial Corpn. Ltd. v. Lazor Detergents P. Ltd.,* (1994) 81 Com Cases 617 (CLB—Mad). This was one of the complications among others which the Madras High Court on appeal took into account to hold that the company should not be allowed to rectify the register on a technical ground after having accepted the transfers. *Kothari Industrial Corpn. Ltd. v. Lazor Detergents P. Ltd.,* (1994) 81 Com Cases 669 (Mad). The decision of the single judge was **affirmed** by the Division Bench in *Kothari Industrial Corpn. Ltd. v. Lazor Detergents P. Ltd.,* (1994) 81 Com Cases 699 (Mad—DB).

Position under the Securities Contracts (Regulation) Act.—As regards the position of a transferor after transfer, section 27 of the Securities Contracts (Regulation) Act (XLII of 1956) may also be noted. It provides as follows:

"S. 27. Title to dividends—It shall be lawful for the holder of any security whose name appears on the books of the company issuing the said security to receive and retain any dividend declared by the company in respect thereof for any year, notwithstanding that the said security has already been transferred by him for consideration, unless the transferee, who claims the dividend from the transferor has lodged the security and all other documents relating to the transfer which may be required by the company with the company for being registered in his name within fifteen days of the date on which the dividend became due.

Explanation:—The period specified in this section shall be extended—

(i) in case of death of the transferee, by the actual period taken by his legal representative to establish his claim to the dividend;

(ii) in case of loss of the transfer deed by theft or any other cause beyond the control of the transferee, by the actual period taken for the replacement thereof; and

(iii) in case of delay in the lodging of any security and other documents relating to the transfer due to causes connected with the post, by the actual period of the delay.

(2) Nothing contained in sub-section (1) shall affect—

(a) the right of a company to pay any dividend which has become due to any person whose name is for the time being registered in the books of the company as the holder of the security in respect of which the dividend has become due; or

(b) the right of the transferee of any security to enforce against the transferor or any other person his rights, if any, in relation to the transfer in any case where the company has refused to register the transfer of the security to the name of the transferee".

Signature of transferor and witnesses

Requirement of attestation of transferors signature, becomes necessary only when the signature does not agree or when the execution is by thumb impression. *Hemangini Finance & Leasing (P.) Ltd. v. Tamilnad Mercantile Bank Ltd., (infra)*.

Regarding the refusal to transfer shares on the ground that the transfer deeds did not bear the name of the witness, the CLB ruled that since the signature of the witness on the impugned transfer deeds was legible, though the name of the witness was not mentioned, the same had to be considered good delivery in accordance with the guidelines issued by the Ministry of Finance and, therefore, the company was wrong in rejecting the registration of transfer of the impugned shares lodged by the transferee company. *Jagatjit Industries Ltd. v. Mohan Meakin Ltd.*, (1994) 80 Com Cases 411 (CLB).

Indication of occupation of transferee company not necessary

When the transferee is a company the question arises that what should be the proper entry in the column in the transfer form which has to show the transferee's 'occupation'. In the present case, 'the column' mentioned only the word 'company' and its folio number of the registration, and no occupation was mentioned. The CLB held that this was the sufficient compliance because only individuals have to be identified by their occupations and not corporate bodies. The objects of a corporate body and, therefore, its occupation are matters of public knowledge. *Jagatjit Industries Ltd. v. Mohan Meakin Ltd.*, (1991) 2 Comp LJ 288, 303, 304 : (1994) 80 Com Cases 411 (CLB). This case was **followed** in *Hemangini Leasing P. Ltd. v. Tamilnad Bank*, (1996) 86 Com Cases 875 (CLB—Mad).

To whom the rejected documents must be returned

The CLB pointed out that the company on not registering the transfer should have returned the documents to the party who lodged them (the transferee in this case) and not the transferor. This is so because it is an admitted position in law that the transferor loses his right in the shares as soon as he executes the transfer in blank. It is an established practice in the corporate sector that the share scrips are returned to the transferor or the transferee, who lodged the instrument of transfer. It is clear from *Circular No.* F/37/SE-79, dated 29th December, 1970, issued by the Ministry of Finance, Department of Economic Affairs, regarding delay in registering transfers, that the share certificates have to be returned to the parties concerned, which can only be the transferees in the present appeals. The company had neither complied with the letter nor the spirit behind the above

circular and had chosen to return the share scrips to the transferors, apparently, with a view to harassing the appellant-transferees. *Jagatjit Industries Ltd. v. Mohan Meakin Ltd.*, (1991) 1 Comp LJ 288 (CLB).

The company does not have the power to impound documents which are not duly stamped or where stamps are not cancelled and to send them to the Collector for taking action. Such documents should be returned to the persons lodging them pointing out the errors so as to enable them to rectify the error. Sending them to the Collector would be an illegal decision on the part of the company and of no effect. *Bharat Hotels Ltd., Re,* (1994) 81 Com Cases 896 (CLB). To the same effect is the decision in *C.H. Joshi v. Bombay Papers Ltd.*, (1991) 72 Com Cases 173 (CLB). Where the company retained the share certificates for a period of more than 2 years without any justification, the company was directed to return them forthwith to the party who lodged them.

Transfer by way of gift

The gift of a part of dividend received on certain shares does not amount to a gift of the corpus of shares also. *Khadija v. P.K. Mohammed (P.) Ltd., In re,* (1985) 58 Com Cases 543 (Ker).

A gratuitous transfer of shares may sometimes also be effective to transfer an equitable title to the shares. In two cases, each coincidentally named *Re, Rose,* reported in (1948) 2 All ER 971 and (1952) 1 All ER 1217, it has been held that where a donor of shares has done everything in his power to divest himself in favour of the donee (*e.g.* by delivering to the donee, or to the company, an executed transfer and the relevant share certificate), the gift is complete in equity despite the absence of registration. This rule applies even where the directors have a discretion to refuse registration of the transfer. The old ruling in *Milroy v. Lord,* (1862) 4 De GF & J 264 that a gift of shares by deed is ineffective until registered would seem to be no longer true. The decision of the Supreme Court in *Ramchandra Shelat v. Pranlal Jayanand Thakar,* (1975) 45 Com Cases 43 : AIR 1974 SC 1728 is also a pointer towards this direction. The point was developed by the Supreme Court further by holding that even where transfer forms signed by the transferor are otherwise in blank and are handed over to the transferee alongwith the share scrips by way of gift the transferee's title will be complete even before registration.

Where the gift of shares was complete as between the donor (father) and the donee (daughter), though it was not registered with the company, it was held that for income-tax purposes the income from the shares could be added to the income of the donee (daughter). *Subba Naidu (R.) v. CGT,* (1969) 39 Com Cases 766 (Mad). A gift of shares *inter vivos* is not the less efficacious because registration by the company is not yet effected. *Midland Bank Executor & Trustee Co. Ltd. v. Bose,* (1949) Ch 78 (Ch D).

A donor of shares intended to make the donee a director in the company by gifting him with qualifying shares. The donor signed the share transfer form. The auditors of the company informed the donee of the share transfer and asked him to complete the prescribed form for his consent to act as a director. The donee signed the form and the donor had countersigned it. The share transfer form was retained by the auditors and not sent to the donee. The donor died leaving behind a will in which she made specific gift of the balance of her shareholding but made no mention of the earlier gift. The executor of the doner's estate sought judicial determination whether there had been a valid equitable transfer of the shares. The Court of Appeal held that the donor had plainly intended to make an immediate gift of the shares. The donee was infomed of it. He had been made a director which he could not have been without the shares being transferred to him. In such circumstances it would have been unconscionable for the donor to recall the gift. The delivery of the share transfer certificate to the company or to the donee was not required for a valid equitable assignment. This was an appeal against the decision of the Chancery Division where it was held that the gift of shares became effective when the donor signed the transfer form. There was no requirement that the form should have been delivered to the company or the donee in order to make the gift complete. Hence, the

shares did not form part of the donor's residuary estate. *Pennington v. Waine,* (2002) 1 WLR 2075 (CA) : (2003) 113 Com Cases 197.

Transfer for nominal consideration

The Supreme Court has laid down that transfer of 2400 ordinary and 100 preference shares for Rs. one only is a transfer without consideration and therefore void *John Tinson & Co. P. Ltd. v. Surjeet Malhan (Mrs.),* (1997) 88 Com Cases 750 : AIR 1997 SC 1411. Whether the decision is sound on the point of consideration in view of s. 25 of the Contract Act providing in one of its Explanations that inadequacy of consideration is no defence, the decision is sound on this point that the transfer was effected by the husband of the owner without the later's authority.

§ See also, Notes under "Blank Transfers", *ante.*

Transfer on price to be determined

It has been held that it is permissible to the parties to agree to transfer of shares at a price to be determined later. It will not render the transfer void. *M.S. Madhusoodanan v. Kerala Kaumudi P. Ltd.,* (2003) 117 Com Cases 19 (SC) : (2003) 55 CLA 372 : (2003) 46 SCL 695. The Supreme Court also noted in this case that the transfer deeds were placed before the directors for approval. That created a presumption that the transfer deeds were properly executed and mandatory requirements satisfied.

Mode of valuation

The mode of valuation adopted was **affirmed** by the Court of Appeal in *Pllat v. Platt,* (2001) 1 BCLC 698 (CA). CHADWICK LJ [at p. 716] hinted that the possibility that "a business might be sold as a going concern for a price equal to the net realisable value of the assets employed was clearly envisaged by Lord REID in *A.G. of Ceylone v. Mackie,* (1952) 2 All ER 775 at 799 F-G, when he said, in a passage cited by the editors of *Tolley's Shares and Business Valuation Handbook,* [at para 6.3], that : 'If it is proved that in a particular case that at the relevant date the business could not have been sold for more than the value of its tangible assets, then that must be taken to be its value as a going concern'. In *Gillat v. Sky Televe Sim Ltd.,* (2000) 2 BCLC 103 (CA), the Court refused to change the mode of valuation which was adopted by the parties.

Where shares have to be transferred or paid for at a valuation and, there is a specific provision in the contract as to mode of valuation, authorities on the point of valuation indicate that there is a distinction between cases where the method of ascertaining the price is an essential term and cases where the method of ascertainment is subsidiary and non-essential. This observation occurs in the judgment in *Gillat v. Sky Television Ltd.,* (2000) 2 BCLC 103 (CA). In this case a business was taken over under an agreement which provided that if the business was resold, a company owned by the original seller should get 55% of the open market value of the shares in the business as determined by an independent chartered accountant. The court said that the expression "as determined by an independent chartered accountant" was an integral and essential part of the definition of the payments to which the company was entitled. The reference to the determination of the independent chartered accountant was not merely a mechanism or permissive procedure for dispute resolution. The reference to "open market value" did not provide the Court with adequate objective criteria to determine the value of the shares. The facts of the case did not show any breakdown of the valuation machinery. The parties simply failed to operate it. That did not entitle the Court to substitute its own opinion on open market value in place of what was agreed between the parties.

In *Renuka Datta v. Solvay Pharmaceuticals B.V,* (2003) 57 CLA 134 : (2003) 117 Com Cases 585 : (2004) 1 Comp LJ 106 (SC), under a settlement between the parties all their pending suits were to be withdrawn and the 3.91% of the husband-and-wife holding in two companies was to be transferred to the other party and their value was to be fixed by a well-known chartered accountant. It was held by the Supreme Court that it would not reject the valuation so worked out if there was nothing to show that it was contrary to the

principles laid down by the Supreme Court in *Smt. Kusumben D. Mahadevia,* [1980] 2 SCC 238. After referring to *CWT v. Mahadeo Jalan,* [1973] 3 SCC 157 wherein certain principles regarding valuation of shares were laid down, it was observed, thus:

"It is clear from this decision that where the shares in a public limited company are quoted on the stock exchange and there are dealings in them, the price prevailing on the valuation date would represent the value of the shares. But where the shares in a public limited company are not quoted on the stock exchange or the shares are in a private limited company the proper method of valuation to be adopted would be the profit-earning method. This method may be applied by taking the dividends as reflecting the profit-earning capacity of the company on reasonable commercial basis but if it is found that the dividends do not correctly reflect the profit earning capacity because only a small proportion of the profits is distributed by way of dividends and a large amount of profits is systematically accumulated in the form of reserves, the dividend method of valuation may be rejected and the valuation may be made by reference to the profits. The profit-earning method takes into account the profits which the company has been making and should be capable of making and the valuation, according to this method is based on the average maintainable profits."

The Court found no evidence of the fact that the valuation in the case was running counter to the principles enunciated in the above cited ruling.

Securities under Depository mode not liable to stamp duty

Issue of shares and transfer of securities under depository mode are not liable to stamp duty in terms of section 8A of the Indian Stamp Act, 1899, inserted by the Depositories Act, 1996.

Inter-depository transfer of securities

SEBI Press Release, dated 23-08-1999.—Based on the views of the Law Ministry, the Ministry of Finance has clarified that inter-depository transfer of shares does not attract stamp duty. It has also been clarified that inter-depository transfer of securities does not require compliance with the formalities prescribed under section 108 of the Companies Act, 1956. It may be recalled that in the recent past doubts were being raised in the market on the above issues. Today's clarification puts these doubts to rest. The Registrars and the Depositories are being advised by SEBI on the above clarification. Ref. No. PR. 187/99 [*Issued by the SMDRP Department, SEBI, dated 23rd August, 1999*]

Stamp duty on transfer of shares

The Stamp Duty is levied under Article 62(a), Schedule I of Indian Stamp Act, on the transfer of shares.

Stamp Duty.—The Stamp Duty under Article 62(a), Schedule I of Indian Stamp Act, 1899, on the transfer of shares is seventy five naye paisa for every one hundred rupees or part thereof of the value of shares subject to reduction and remission as follows:

Reduction and remission of stamp duty.—w.e.f. 1-6-1976.—Reduced with effect from 1st June, 1976 *vide* Notfn. S.O. 198(E), dt. 16-3-1976. The duty with which an instrument of transfer of shares in an incorporated company or other body corporate chargeable under Article 62(a) of Schedule I of the Indian Stamp Act, 1899, is fifty paise for every hundred rupees or part thereof of the value of the share, amended *vide* S.O. 198(E), dated 16th March, 1976) (superseding earlier Notfn. 7/65, dated 26th March, 1966).

—w.e.f. 1-3-2004.—Further reduced with effect from 1st March, 2004 *vide* Notfn. S.O. 130(E), dt. 28-1-2004. The proper stamp duty chargeable on an instrument of transfer of shares in an incorporated company or other body corporate chargeable under Article 62(a) of Schedule I of the Indian Stamp Act, 1899, is twenty five paise for every hundred rupees or part thereof of the value of share. The duty chargeable shall, whereever necessary, be rounded off to the next five paise (Explanation 2), amended *vide* Notfn. No. S.O. 130(E), dt. 28-1-2004 issued by Deptt. of Revenue (superseding earlier Notfn. S.O. 198(E), dt. 16-3-1976).

The Stamp duty varies from State to State. For the Schedule of Stamp duty refer, K. KRISHNAMURTHY – INDIAN STAMP ACT, 1899 (8th Edn.), 2002.

It is necessary that the value of the consideration paid for a transfer must be determined as a part of the agreement because in the absence of such valuation it would not be possible to know whether stamp duty has been paid according to value or not. A transfer form which does not indicate the value of the shares for the purposes of transfer would be void and not capable of being accepted. *Mani (M.S.) v. M.S. Madhusoodan,* (1991) 5 Corpt LA 187 (Ker—DB).

The "value of the shares" means the price which the shares would fetch at the time of the transfer and not the face value of the shares. The consideration actually paid or agreed to be paid is the value of the shares. So long as there is nothing to indicate that the consideration was not truly stated in the transfer, the one mentioned therein should be accepted as the consideration that was paid. *Union of India v. Kulu Valley Transport Ltd.,* (1958) 28 Com Cases 29 at 36 (P&H).

If a company registers an instrument of transfer which is not duly stamped, it will be doing an act which is unlawful. But neither under the Companies Act nor under the Stamp Act is the company liable for making good the amount of the stamp duty. *In re, Jagdish Mills Ltd.,* (1954) 24 Com Cases 241 : AIR 1955 Bom 79.

'Duly stamped'.—The instrument of transfer must have been stamped with the proper stamp when it is delivered to the company. The general practice of sending the deed of transfer along with a cheque or remittance of the amount required for stamping is not sufficient compliance with the requirement of the section. There is no obligation on the part of the company to receive the instrument of transfer without the requisite stamp affixed to it, even when it is accompanied by sufficient money to cover the stamp duty and with a request that the stamping may be done by the company.

There is no obligation on the part of a company to cancel the stamps. *Nuddea Tea Co. Ltd. v. Ashok Kumar Saha,* (1988) 64 Com Cases 775 (DB) (Cal); *Jagdish Mills Ltd., In re, (Supra)*; *Babulal Choukhani v. Western India Theatres Ltd.,* (1958) 28 Com Cases 565 : AIR 1957 Cal 709 (DB) (Cal); *Kothari Industrial Corpn. Ltd. v. Lazor Detergents P. Ltd.,* (1994) 81 Com Cases 699 (Mad—DB).

But there is no legal objection to a company receiving the amount of the stamp duty and affixing the stamp to the transfer application. In such a case the application, as an instrument of transfer will be considered as delivered to the company only after the stamp is affixed. The company will be deemed to be doing an agency service to the applicant as regards the stamping of the instrument.

Section 17 of the Stamp Act also requires stamping before or at the time of execution. However, Orissa High Court has held in *Prafulla Kumar Rout v. Orient Engg. Works P. Ltd.,* (1986) 60 Com Cases 65 (Ori), that a transfer form can be stamped even after execution. The liability to pay the stamp duty is on the transferor in the absence of a contract to the contrary, as per section 29 of the Stamp Act. See also *G.R. Parry v. Union of India,* (1962) 32 Com Cases 145 (Punj—DB).

Directors may refuse to register a transfer which is not properly stamped although the stamp affixed on it is in accordance with the consideration incorrectly stated in the transfer. *Maynard v. Consolidated Kent Collieries Corpn.,* (1903) 2 KB 121 (CA); *Conybear v. British Briquettes Ltd.,* (1937) 4 All ER 191. But where a transfer with an insufficient stamp has been registered, the name of the transferee cannot be removed from the register after the proper stamp duty and penalty has been paid. *Indo-China Steam Navigation Co.,* (1917) 2 Ch 100; *Conybear's* case, *(Supra)*; *Nisbet v. Shepherd,* (1994) 1 BCLC 300. The directors are not bound to register a transfer unless the application complies with the requirements of the section. *Hemlata Saha v. Stadmed (P.) Ltd.,* (1964) 34 Com Cases 875 (Cal).

If an instrument of transfer does not bear the stamp before or at the time of execution, the directors are under no obligation to register the transfer. They may reject it *in limine*. See *Babulal Choukhani v. Western India Theatres Ltd.,* (1958) 28 Com Cases 565 (Cal); *Cf. Union of India v. Kulu Valley Transports Ltd.,* (1958) 28 Com Cases 29 (Punj); *New Citizen Bank of India v. Asian Assurance Company Limited,* (1945) 15 Com Cases 53 (Bom); *Amraoti Electric Supply Co. v. Chandak,* (1954) 24 Com Cases 465, 471 (Nag). *In Re, Coronation Tea Co. Ltd.,* (1962) 32 Com Cases 568 : AIR 1961 Cal 528, it is further held that "duly stamped" includes also effective cancellation of the stamps, and unless an instrument of transfer is not only duly stamped, that is, stamped with proper stamps but also cancelled as required, by section 12 of the Stamp Act, before it is received by the company, the company will be justified in refusing the registration of the transfer. This case has been followed by the Company Law Board in disposing of appeals under section 111 (Appeals Nos. 5 to 12 of 1972) *Madanlal Patodia v. Laxmi Narayan Cotton Mills Ltd.* See also *Nuddea Tea Co. Ltd. v. Ashok Kumar Saha,* (1988) 64 Com Cases 775 (Cal); *Chandrashekhar Hari Joshi v. Bombay Papers Ltd.,* (1991) 2 Comp LJ 424 (CLB).

In *Jagatjit Industries Ltd. v. Mohan Meakin Ltd.,* (1994) 80 Com Cases 411 (CLB) where objections of the above kind relating to the time at which the instrument should have been stamped were overruled and it was held to be a sufficient compliance if the instrument was duly stamped at the time of its lodgement with the company.

'Duly stamped' means not only that stamps for the proper amount of duty are affixed, but also that the stamps must be valid. A transfer deed executed in 1965 with stamps bearing the likeness of King George VI was held to be not duly stamped. *Mahabir Singh v. Jai Singh,* (1978) 48 Com Cases 558 (Del).

In the case of a blank transfer although a blank transfer deed may pass property in the shares as between the purchaser and the seller, the company cannot register such transfer unless it is filled up and duly stamped. *Bank of Hindustan Ltd. v. Kowtha Suryanarayana Rao,* (1958) 28 Com Cases 71 : AIR 1957 Mad 702.

Cancellation of stamps at the time of execution.—The cancellation of the stamp as per S. 12 of the Indian Stamp Act is expected to be done either when the stamps are affixed or when the instrument is executed. Judicial pronouncements have cleared the doubt as regards the simultaneous nature of the action of cancellation of the stamp and signing the instrument. The stamps must be cancelled either immediately they are affixed or immediately after the maker put his signature. Since in this case the instrument of transfer was not duly stamped because the adhesive stamps had not been cancelled at the time of execution, and were only cancelled before presenting the instrument to the company, the Board of directors were justified in rejecting the same. *Mathrubhumi Printing and Publishing Co. Ltd. v. Vardhaman Publishers Ltd.,* (1992) 73 Com Cases 80, 93 (DB) (Ker); **reversing** *Vardhaman Publishers Ltd. v. Mathrubhumi Printing and Publishing Co. Ltd.,* (1991) 71 Com Cases 1 (Ker). The Court summarised the effect of authorities as to when a document can be said to be duly stamped at page 91 of the Report. The case of *Mathrubhumi* was **followed** by the Karnataka High Court in *Muniyamma v. Arathi Cine Enterprises P. Ltd.,* (1993) 77 Com Cases 97 (DB). To the same effect *Seshasayee Paper and Boards v. Riddhi Chordia & Mool Chand Chordia,* (1998) 93 Com Cases 606 : (1997) 2 Comp LJ 249 (CLB–SB).

Time for pointing out insufficiency of stamps.—Where a company by mistake or otherwise registers a transfer which should have been refused because of insufficient or uncancelled stamps, or because of the instrument being unstamped, it should point out the error to the transferee within such time (within one year from the date of execution) that the transferee can have the matters rectified through the orders of the Collector. Afterwards it would be too late. *Kothari Industrial Corpn. Ltd. v. Lazor Detergents P. Ltd.,* (1994) 81 Com Cases 617 (CLB—Mad). **Affirming** this decision on appeal in *Kothari Industries Corpn. Ltd. v. Lazor Detergents P. Ltd.,* (1994) 81 Com Cases 669 (Mad) the Madras High Court noted serious complications and confusion of the stock market to the detriment of free transferability if a company could be permitted to remove names from its Register of members which it had earlier registered in spite of a technical defect. The court noted that full stamp duty was paid. The State suffered no loss of revenue. The requirement of cancellation was directory and not mandatory. Registration of a transfer form with uncancelled stamps was only an irregularity and not illegality. The company should not be allowed to raise its own irregularity after a lapse of time. The decision of the single judge was **affirmed** by the Division Bench in *Kothari Industrial Corpn. Ltd. v. Lazor Detergents P. Ltd.,* (1994) 81 Com Cases 699 (Mad—DB).

Where the transfer form was returned to the applicant because stamps were not defaced and by the time that he could send it back to the company after defacing the 2 months time prescribed under section 108(1-A)(b)(ii), as it stood before the amendment of 1988, had expired, the company's refusal to register the share transfer was upheld by the Company Law Board. *A.S. Manvi v. Kritapur Pressing & Ginning Factory Ltd.,* (1989) 3 Comp LJ 217, 220 (CLB).

§ See also Notes under s. 111, under the heading "Refusal on the ground of failure to affix/cancel adhesive stamp on transfer deed".

Collector's certificate of proper stamping under S. 40 of the Stamp Act.—Where there is doubt as to the proper stamp duty payable the matter may be referred for adjudication by the Collector.

Section 108 requires that when a share transfer form is delivered to the Board of directors it should be duly stamped. Retrospective effect given by the Collector's certificate under section 40 of the Stamp Act does not meet the requirements of section 108 of the Companies Act. Endorsement by the Collector on the documents impounded will make it admissible as a "duly stamped" document for the purposes of evidence but unless such a document was duly stamped when it was delivered to the company for registration, it could not be said that it had fulfilled the mandatory requirements of section 108. *Patel Engineering Co. Ltd. v. B.Y. Investments Pvt. Ltd.*, (Ref. Nos. 12 to 20/SC/CLB/WR/91 decided on 28-7-1992 by CLB).

Board of directors cannot impound documents not duly stamped.—The Board of directors are not persons in charge of a public office under sections 33 and 42 of the Stamp Act and cannot impound or regularise an instrument of transfer which is not duly stamped. *Mathrubhumi Co. Ltd. v. Vardhaman Publishers Ltd.*, (1992) 73 Com Cases 80, 93 (DB) (Ker). The decision of the single judge in *Vardhman Publishers Ltd. v. Mathrubhumi Printing and Publishing Co. Ltd.*, (1991) 71 Com Cases 1, 44 (Ker) was **reversed** on other grounds.

Denomination of Share Transfer Stamps.—The Government of India had received suggestion to change the denomination of share transfer stamps keeping in view the share value of present day and increased volume of transactions. At present share transfer stamps are being printed in denominations of Rs. 50, 10, 5, 2, 1 and 0.50 Paise. It was felt that denominations of share transfer stamps presently prescribed is too low. Accordingly, it has been decided by the Government to introduce two new share transfer stamps of the denominations of Rs. 100 and Rs. 200 in order to facilitate share transfer and improve the availability of share transfer stamps. [*Press Release, dated 10-5-1995, issued by the Ministry of Finance, Department of Revenue (Sales Tax Wing)*]

Whether transferee/transferor to be heard by Board of directors

No opportunity to be heard need be given by the Board of directors to transferees of shares of a company before passing a resolution to register the transfer. *Vardhman Publishers Ltd. v. Mathrubhumi Printing and Publishing Co. Ltd.*, (1991) 71 Com Cases 1, 44. **Reversed** on appeal on other points in *Mathrubhumi Printing and Publishing Co. Ltd. v. Vardhaman Publishers Ltd.*, (*Supra*).

Refusal to transfer on frivolous grounds such as non-tally of attested signature

Department's Circular I.—It has been brought to the notice of this Department that certain companies are returning instruments of transfer without effecting transfer of shares in the names of transferees on frivolous grounds, *inter alia*, that the specimen signatures of transferors do not tally with that on record, in spite of the fact that the transfer forms bear attestation of the magistrates, *etc.* In this connection, it may be stated that as per instructions below the prescribed share transfer form (No. 7-B) "attestation, where required, of thumb impression, marks, signatures, *etc.*, should be done by a magistrate, notary public or special executive magistrate or a similar authority holding a public office or a member of a recognised stock exchange through whom the shares are introduced or a member of the transferor's bank." Further, the guidelines for good or bad delivery issued by the Ministry of Finance, Department of Economic Affairs, *vide* their *Circular No.* 1/10/SE/83, dated 21-7-1983 also provide a similar requirement.* You are, therefore, requested to advise your constituent member companies to follow the aforesaid instructions scrupulously and to effect transfer of shares within the period prescribed under section 113 of the Companies Act, 1956, and the listing guidelines". (*Circular No.* (3 of 1993, dated 22-3-1993).

Department's Circular II.—"I am directed to refer to this Department's Circular No. 3/93, dated 22-3-1993, on the above subject, in which companies were advised not to return transfer deeds on the ground, *inter alia*, that the signatures of the transferor do not tally, where the same are attested by Notary Public, Stock Broker, Magistrate *etc.*, and to say that it has been represented to this Department that in some cases, although the signatures are attested by Notary Public, the same do not tally or the signatures have not been properly attested, which may give rise to disputes. In view of these representations, the companies concerned are advised to satisfy themselves where there is doubt/apprehension about the genuineness of signatures by making a reference to the transferor. Such cases will, however, be more by way of exception rather than as a general rule." (*Circular No.* 10/93; *File No.* 3/4/92-CL-V, dated 13-8-1993).

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* SEBI has issued Uniform Norms for Good and Bad Deliveries *vide* Press Release No. 68/96 : Circular No. SMD/RCG/2796/96, dt. 16-07-1996 at *Appendix* 258.

Defective transfer deed

Where an instrument is not complete or is erroneous, it will be a case of bad delivery and the company would be entitled to refuse registration. The transferor is bound to rectify the errors and lodge the transfer within the prescribed time-limit from the date of presentation to the prescribed authority, failing which the investor will have to make the application to the Central Government under the provisions of section 108(1D) for extension of the prescribed period for delivery of the transfer deed.

GUIDELINES FOR UNIFORM NORMS FOR PROCESSING SHARE TRANSFERS BY COMPANY, REGISTRARS TO ISSUE AND SHARE TRANSFER AGENTS

RTI Circular No. 1 (2000-2001), dt. 9-5-2001, issued by the SEBI, Primary Market Department.—All companies listed on stock exchanges are required to do the processing of share transfers and effect transfers in accordance with the provisions of the Companies Act, 1956, listing agreement and the guidelines issued by SEBI. It has been observed that there are no uniform procedures or practices adopted by companies and their registrars to issue ('RTI')/share transfer agents ('STA') for handling and processing of transfer documents/bad delivery documents/stock invests, etc., resulting in avoidable confusion and inconvenience to the investors. The Stock Exchange, Mumbai and National Stock Exchange had set up task forces to evolve uniform norms in these areas. The task forces submitted their recommendations to SEBI. SEBI thereafter convened meetings of representatives of Registrar Association of India, stock exchanges, clearing corporation, depositories and custodians to finalise these norms. After detailed deliberations uniform guidelines to be followed by RTI/STA and Companies have been agreed upon by the various market intermediaries. These guidelines have been divided into three parts:

1. General norms for processing of documents
2. Norms for processing transfers
3. Norms for declining objection.

§ For text of the 'Uniform Norms', for Processing Share Transfers by Company, see *Appendix* 258.

Good and Bad Deliveries—SEBI Uniform Norms

Press Release, No. 68 of 96, dt. 16-7-1996.—SEBI has issued a Press Note as to Uniform Norms for Good and Bad Deliveries of Shares and Debentures:

Uniform guidelines for Good or Bad Delivery of Documents have been prepared after taking into consideration the suggestions made by various Financial Institutions and Stock Exchanges. For the text of the Uniform Norms for Good and Bad Deliveries issued by SEBI as amended from time to time, see *Appendix* 258.

Delegation of powers for registration of transfer

The power for acceptance or refusal of shares lies with the Board of directors. The power may be delegated by the Board to a committee of directors or to officers of the company. Even a periodic reporting to the Board on share transfer would not be necessary if the terms of delegation of the power so provide. However, the ultimate responsibility for share transfers vests with the Board.

Registration of transfer, compliance with s. 108 mandatory

Although the registering of a transfer without a proper instrument of transfer is illegal, it has been held by the Kerala High Court that registration of a transfer without production of the share certificate is not invalid. *Philipose (E.J.) v. Vanchinad Rubber Produce Co. Ltd.*, (1953) 23 Com Cases 536 : AIR 1952 Trav Co 253. The Allahabad High Court also has held that the provisions of sub-section (1) are not mandatory but only directory and, therefore, the registration of a transfer of shares without an instrument of transfer is not void. *Maheshwari Khetan Sugar Mills v. Ishwari Khetan Sugar Mills*, (1963) 33 Com Cases 1142 (All–DB).

The above decision of the Allahabad High Court has since been **reversed** by the Supreme Court in *Mannalal Khetan v. Kedar Nath Khetan*, (1977) 47 Com Cases 185 : AIR 1977 SC 536 where the mandatory nature of the provisions of sub-section (1) of section 108 has been elaborately discussed and emphasised. The result is that without production of the share certificate along with the application for transfer, the transfer cannot be reg-

istered and if registered' the registration will be void. The Supreme Court decision was **followed** in *P.V. Chandran v. Malabar & Pioneer Hosiery (P.) Ltd.*, (1990) 69 Com Cases 164, 175 (Ker) which was **affirmed** in *In re, Malabar & Pioneer Hosiery (P.) Ltd.*, (1985) 57 Com Cases 570 (Ker). However, in the case of *Hoshiarpur Azad Transporters (P.) Ltd. v. Hoshiarpur Express Transport Co.*, (1983) 54 Com Cases 254 (P & H), the transferees had not signed the transfer forms and yet the transferees' names were entered in the register of members. The Court held that the Register was in that case conclusive evidence of the transferees having become members of the company in respect of all the shares registered in their names. The finding was made even though the share scrips had not been delivered to the company for making necessary changes. This decision appears to be incorrect in view of the decision of the Supreme Court in *Mannalal Khetan* (*Supra*).

The Company Law Board took note of the Supreme Court view (*Mannalal Khetan's* case, *Supra*) that the requirements of section 108 are mandatory and said: From the provisions of this section it is clear that the following requirements have to be satisfied before a company registers a transfer: (*a*) Prescribed form is to be used; (*b*) It has to be duly stamped; (*c*) It has to be executed by and on behalf of the transferor and by or on behalf of the transferee; (*d*) The name, address, occupation, if any, of the transferee have to be specified; (*e*) Instrument of transfer has to be delivered along with the certificates relating to the shares, within a specified period of time. The omission from the transfer forms of the particulars regarding consideration, the date of execution, the address of the transferor and the transferee and the stamp duty would render the instrument defective. Some of the transfers were refused on the ground that the occupation of the appellant had not been indicated. Since all the appellants were investment companies and they have already affixed the rubber stamp of their names as transferees, omission to mention occupation did not invalidate the instruments *Jagatjit Industries Ltd. v. Mohan Meakin Ltd.*, (1994) 80 Com Cases 411 (CLB).

In reference to the provision of S. 108(1A), requiring transfer forms to be submitted within the time prescribed, the Karnataka High Court has held in *Mukundlal Manchanda v. Prakash Roadlines Ltd.*, (1991) 72 Com Cases 575, 585 (Kar) that the requirement is of directory nature and not mandatory. Consequently the acceptance of a transfer outside the time frame does not necessarily make it invalid. The single judge decision was **affirmed** in *Mukundlal Manchanda v. Prakash Roadlines Ltd.*, (1995) 1 Comp LJ 126 (Kant—DB). The decision of the Supreme Court in *Mannalal Khetan* (*Supra*) was **distinguished** on the ground that it belonged to a period before section 108(1A) was inserted in the Act.

If a transfer is registered in contravention of this section, the register may be rectified by the Court. *Re, Greene,* (1949) 1 All ER 167 (Ch D).

As stated in BUCKLEY ON COMPANIES ACTS (14th Edn., pages 934-935), long lapse of time coupled with recognition of the transferee as a shareholder may render a transfer incapable of being impeached; *Bush's* case, (1870) 6 Ch App 246; *affd. sub nom. Murray v. Bush* (1873) LR 6 HL 37 where the decisions of the House of Lords was equally decided; but this can be justified only on the ground of estoppel or a subsequent implied contract, and not on the basis of title derived from the transferor. In a decision of the Court of Appeal in England. *In re, Paradise Motor Co. Ltd.*, (1968) 2 All ER 625 (CA), there is also a view expressed that the registration of a defective transfer of shares may be regarded after a long lapse of time as a mere irregularity and not a nullity, as the object of section 75 of the English Act was only to prevent the avoidance of payment of stamp duty. But as the language of the present section appears to be mandatory, the words used are "shall not register", and any transfer which does not comply with its requirements will not be valid.

No opportunity to be heard need be given by the Board of directors to transferees of shares of a company before passing a resolution to register the transfer. *Vardhman Publishers Ltd. v. Mathrubhumi Ltd.*, (1991) 71 Com Cases 1, 44. **Reversed** on appeal on

other points in *Mathrubhumi Co. Ltd. v. Vardhaman Publishers Ltd.*, (1992) 73 Com Cases 80 (Ker—DB).

§ See also Notes under heading "Effect of transfer".

Transfer of letters of allotment

An allottee of bonds transferred the bonds by means of the letter of allotment even before the company had issued bond certificates. The company refused to register the transfer. The transferee approached the Company Law Board and also during the pendency of the proceeding returned the bonds to the original allottee. The latter was not allowed to file an appeal against the decision of the CLB. The allottee could have been impleaded only with the leave of the Court, which he had not taken. *Power Grid Corpn. of India Ltd. v. City bank N.A.*, (2002) 40 SCL 835 : (2003) 113 Com Cases 171 (Delhi),

Transfer in violation of articles

Where the articles of a private company require that transfers of the company shares should be made with the previous sanction of the company's Board of directors, the Supreme Court held that any transfer without such approval would be invalid. *John Tinson & Co. P. Ltd. v. Surjeet Malhan (Mrs.)*, (1997) 88 Com Cases 750: AIR 1997 SC 1411.

Where a transfer was made in violation of a private company's articles requiring that shares must be first offered to existing members, it was held that the transferor was not the proper person to object. *Prafulla Kumar Rout v. Orient Engineering Works (P.) Ltd.*, (1986) 60 Com Cases 65 (Ori).

Payment of transfer fee prescribed by articles.—The Kerala High Court has emphasized in *Re, Malabar and Pioneer Hosiery P. Ltd.*, (1985) 57 Com Cases 570 (Ker) that the requirements of the company's articles must also be complied with. The articles of a company required that every instrument of transfer must be accompanied by the share certificate and a fee for registration of transfer. An application made without compliance with these requirements was held to be rightly rejected. The transferee was not entitled to deposit the fee and the share certificate in the court. They have to be deposited in the company for proper compliance. **Affirmed** in *P.V. Chandran v. Malabar & Pioneer Hosiery P. Ltd.*, (1990) 69 Com Cases 164 (Ker–DB).

"The non-compliance with the requirements prescribed by the article is fatal, it cannot be cured by offering to file the share certificate and a demand draft for the fee in the court. The court has no jurisdiction to accept the documents and the fee (see *P.V. Chandran's* case, (1990) 69 Com Cases 164 (Ker). The learned judge in that decision has observed thus: "It is only after the instrument of transfer along with the share certificate and the registration fee are delivered or left at the office of the company duly, does the occasion for the directors to consider the matter arise." This decision of the learned single judge was **affirmed** in appeal by the Division Bench in *Chandran (P.V.) v. Malabar and Pioneer Hosiery P. Ltd*, (1990) 69 Com Cases 164 (Ker—DB) and ultimately by the Supreme Court by **rejecting** the special leave application. See *Mathrubhumi Printing and Publishing Co. Ltd. v. Vardhman Publishers Ltd.*, (1992) 73 Com Cases 80, 94 (Ker—DB).

Where the transfer fee was not deposited at the time of the lodgement but it was paid before the directors sat to consider the transfer, the requirement was held to have been fully complied with. *Hemangini Finance and Leasing P. Ltd. v. Tamilnad Mercantile Bank Ltd.*, (1996) 86 Com Cases 875 (CLB—Mad).

Under clause 8(a) of the Listing Agreement, listed companies cannot charge any transfer fee for registration of transfers of its shares and debentures. [*Circular letter*, dated 16-01-1964, Stock Exchange Division, Department of Economic Affairs].

Restraining transfer of shares in private company involving violation of articles.—A State Financial Corporation bought shares in a private company for equity support under an arrangement in which the promoters would buy-back the shares from the corporation. The directors present at the meeting approved the proposed transfer to pro-

moters and it was effectuated and yet subsequently sought to restrain the transfer. The allegations were that the minutes of the meeting were not properly recorded, that the transfers and buy-back arrangement were in violation of the company's articles. The court said that these matters could be sorted out at the trial. There was no *prima facie* case for grant of an interim injunction. *J.K. Puri v. H.P. State Industrial Development Corpn.*, (1998) 93 Com Cases 491 (HP).

Agreement amongst Joint Venturers as to transfer of shares

An agreement amongst joint venturers forming a company provided that they would not transfer shares to outsiders without the consent of other venturers. The question whether such a restriction was valid and enforceable, was covered by the arbitration clause as also the question whether the consent was unreasonably withheld. The Court directed the company that *status quo* should be maintained till arbitrator's award and that the company should not side with one or the other venturers. *Bell South International v. Crompton Greaves Ltd.*, (2001) 106 Com Cases 437 (Mad).

Compensation for misrepresentation in sale of shares

The two owners of shares agreed to sell the whole of the issued share capital of a company to the plaintiff. The directors of the company also joined as parties and they warranted that there were no material facts or circumstances in relation to the company which had not been disclosed and which, if disclosed, might have affected the purchaser's decision to enter into the agreement. The warranties turned out to be false. In the plaintiffs' action one of the defences was that they (plaintiffs) knew of the facts not disclosed. The plaintiffs applied for this part of the defence to the struck out because there was another clause in the agreement providing that the plaintiffs would not be precluded by any other information about the company of which they knew. Their application for striking out the defence was not allowed. *Eurocopy plc. v. Teesdale,* 1992 BCLC 1067 (CA).

Where a person sold his entire shareholding in a company to a buyer giving him a warranted forecast of the company's earnings touching a particular figure, but the forecast turned out to be wrong, it was held that the warranty that the results shown in the forecast were achievable was the equivalent to a warranty as to quality and, therefore, the damages were the difference between the warranted earnings and the actual earnings. *Lion Nathan Ltd. v. C.C. Bottlers Ltd.*, (1996) 2 BCLC 371 (PC on appeal from New-Zealand).

In *Smith New Court Securities Ltd. v. Scrimgeour Vickers (Asset Management) Ltd.*, 1992 BCLC 1104 (Ch D), an agent of Citibank made a fraudulent statement that other persons were interested in acquiring the Ferranti shares. That representation was made with the intent and had the effect of inducing the buyer to bid for the shares. If the representation had not been made he would not have made the bid for the shares and accordingly the measure of damages was the difference between what the buyer paid and what the shares were worth at the time of the transaction. *Prima facie* where shares are quoted on the Stock Exchange the true value of the shares is their market value on the date of the transaction but this can be displaced if there is a false market. In assessing the value of the shares, events subsequent to the sale can be taken into account only if they are of relevance in ascertaining the value of the shares at the time of the sale. In assessing the value of shares the court can take into consideration the fact that a fraud other than the one perpetrated by the vendor of the shares had had an effect of creating a false market in the shares. If the purchaser of shares has resold the shares credit should be given for the proceeds of sale but if they have not been resold credit need not have to be given for what he might have obtained had there been a sale unless the purchaser had acted unreasonably or imprudently. The trial judge accordingly allowed by way of damages the difference between the purchase price and the price which the buyer subsequently realised on resale. The Court of Appeal reduced this amount by about ten times so as to correspond to the difference between the purchase price and the market price of the shares were resold immediately. *Smith New Court Securities Ltd. v. Scrimgeour Vickers (Asset Management)*

Ltd., (1994) 2 BCLC 212 (CA). On appeal the House of Lords restored the amount awarded by the trial judge because there was justifiable reason for the buyer not being able to resell immediately after detecting the fraud. The buyer was thus entitled to the difference between the price which he paid for the shares and the price which he obtained on resale. *Smith New Court Securities Ltd. v. Scrimgeour Vickers (Asset Management) Ltd.*, (1997) 1 BCLC 350 (HL).

In the sale by a company of its shares which carried the status of majority shareholdings in its subsidiary, there was a warranty that the last audited accounts of the group of which the company was the parent showed a true and fair view of the group's assets and liabilities and that all the matters in the groups' audited and management accounts were deemed to be disclosed. The buyer company afterwards raised an action for breach of warranty on the ground that the groups principal assets, namely, a football stadium was materially overruled in group's last audited accounts. The court observed that the action was not sustainable since the agreement referred to values at the time of the accounting date and the claim referred to their value at the date of completion. The court also observed that instalments of the unpaid price could not be set off against the sellers' liability for false warranty but said that the buyers may retain the unpaid price till the matter was decided on full trial on merits. *New Hearts Ltd. v. Cosmopolitan Investments Ltd.*, (1997) 2 BCLC 249 [CS-OH] *Cosmopolitan Investments Ltd. v. New Hearts Ltd.*, (1997) 2 BCLC 249 [CS-OH]; See also *Prentice Scottish Power Plc.*, (1997) 2 BCLC 264 [CS-OH] where the agreement required the seller to make disclosures and entitled the buyers to reject the disclosures and to terminate the agreement. The court did not consider whether disclosure meant an *omnibus* disclosure letter or whether the right of termination was to be exercised reasonably and allowed the case to continue in relation to other issues which it raised. See also *Great Future International Ltd. v. Sealand Housing Corp*, [2002] EWHC 2454 : The Times, Dec. 17, 2002, compensation allowed on the basis of the difference between the purchase price and actual value of the shares at the relevant date.

SEBI has introduced regulations under the name "SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Markets) Regulations, 1995 under which SEBI can hold enquiry against and buyer or seller of securities if the transaction shows elements of fraud or unfairness and also call for information and documents from the parties against whom enquiry can be instituted and also from others against whom no enquiry can be instituted. *Karnavati Fincap Ltd. v. SEBI*, (1996) 87 Com Cases 186 (Guj).

Liability of valuer for negligence

A valuer would be liable in tort for negligence in valuation. Valuation can be questioned also in case of mistake. Parties agreeing to be bound by the valuer's reports were held to be not precluded from questioning the validity of the report. *Mihir Chakraborty v. Multi Tech Computers (P.) Ltd.*, (2001) 106 Com Cases 150 : (2001) 3 Comp LJ 150 : (2001) 32 SCL 257 : (2001) CLC 1162 : (2001) 43 CLA 259 (Del).

Duty to disclose truth in writ petition

A writ was filed by shareholders alleging that they were being forced to accept shares in a sister concern on surrender of their shares in the company. The writ was dismissed because it was not disclosed that the shares which were proposed to be allotted were saleable in the market at a higher value as compared with the petitioners' original shareholding. *Ali Jawad Ameerhasan Rizvi v. Indo-French Biotech Enterprises Ltd.*, 2000 CLC 1387 : (2000) 3 Comp LJ 48 (Bom).

Depriving a member of his shares by injurious falsehood

Under an agreement with the company a given number of shares was to be alloted to a founding member with a right to transfer them to a new member on the expansion of the company's membership (a club). He claimed that a blank but signed transfer form was

taken from him for this purpose but the shares were registered in the name of another person in fraud. The court held that the transfer was not valid and therefore the complaining member was entitled by way of compensation to the value of the shares. *Lloyd v. Popely,* (2000) 1 BCLC 19 : 2000 BCC 338 (Ch D). An appeal against this decision was **dismissed** in *Lloyd v. Popely,* (2001) CLY 259 (CA).

Duty of disclosure when director buys from member

There are judicial indications that where a director of a company purchases shares from a member of the same company a fiduciary relationship may arise giving rise to duty to make full and frank disclosure to the selling member of matters relevant to the finances of the company. The court found that the defendant misled the claimants by suggesting that an important supplier would withdraw the franchise if the business was not sold. He misstated the extent of the company's financial troubles. He had said that he would return the shares if no sale materialised but had no intention of keeping that promise. The shares would not have been transferred but for the misrepresentations which were at least negligent.

The measure of damages was the same for misrepresentation and breach of fiduciary duty and consisted of the value of the shares at the time of sale. A valuation based on an estimated future income stream was generally preferable to one based on net realisable assets, but uncertainties in the income position of the business meant that an assets value was preferable in this case. *Platt v. Platt* (1999) 2 BCLC 745 (Ch D).

Ousting liability for breach of warranty

The Court of Appeal considered the construciton of a contract for sale of shares and in particular provisions limiting the liability of the vendor for breach of warranty. Such a limitation clause is liable be construed *contra proferentem. Dixons Group plc v. Murray-Obodynski,* (2000) 1 BCLC 1 (CA).

Transfer/sale of shares under CLB/Court order

A company cannot refuse to comply with an order of the Court under section 111(4). The order can be enforced in the same manner as a decree of Court (section 634).

Where the Court orders rectification of the register by ordering registration of the name of the transferee in respect of shares not produced along with the transfer applications, the Court's order is itself sufficient protection and no further protection by way of an indemnity or otherwise can be insisted upon. *Jatia Cotton Mills Ltd. v. Ram Prasad Bajoria,* (1975) 45 Com Cases 686 (Cal). When duplicate share certificates are issued as per an order of court and subsequently the said order is set aside, the name of the original shareholder should be restored to the register and no transfer form is necessary since no transfer is involved. *Sundaram Pillai v. Century Flour Mills Ltd.,* (1986) 3 Comp LJ 87 (Mad).

Sale of shares under court order becomes effective in favour of the transferee even if the share scrips were not in the possession of the court and therefore the court could not endorse them in favour of the petitioners. The conditions necessary for perfecting the title of an auction purchaser are prescribed by Order XXI Rules 77(2) of the Civil Procedure Code and these conditions were fulfilled in this case. The court ordered the company to rectify its register of members and include the name of the auction purchaser. *Hanuman Mills P. Ltd., Re,* (1977) 47 Com Cases 644 at 650 (All). The court **relied** on *Philipose v. Vanchinad Rubber & Produce Co. Ltd.,* (1953) 23 Com Cases 536 (TC).

In *Mohideen v. Tinnevelly Mills Ltd.,* AIR 1928 Mad 571, the Madras High Court held that where shares are purchased at a Court sale, it is not necessary that the purchaser should obtain a transfer of shares duly executed by the judge as provided for by O. 21 R. 80 of the Civil Procedure Code. The Court also held that articles dealing with the director's right to refuse to register will not apply when shares are purchased at a Court sale. A **contrary view** has been taken by the Nagpur High Court in *B.T. Co. v. Deshpande,* AIR 1956 Nag 20, where the Court held that a purchaser at an auction sale does not automatically become a member of the company. In view of the provisions of O. 21 rules 79 and

80, he can only become a member when a transfer of shares has been completed by the judgment debtor in favour of the purchaser as required by articles 18 and 19 of Table A of the Act of 1913 (now arts. 19, 20). If the judgment debtor refuses to execute the transfer the Court will intervene under O. 21 R. 80 of the Civil Procedure Code to execute the transfer. The Court **disagreed** with the Madras case, and upheld the discretion of the directors to refuse to register a transfer in such cases. The Court pointed out that a purchaser at a Court sale does not purchase, over and above the shares, the absolute right of forcing the directors to register his name. That is a power which the Court never had. An auction does not enlarge the rights of a shareholder. Shares purchased at an auction sale are subject to the same incidents and restrictions as regards transfer, *etc.*, as in other cases. The purchaser of shares at an execution sale by the court of the right, title and interests of a shareholder cannot compel to the company register his name in the register of members, as a matter of right. He is no different from a private purchaser and is subject to the same rules as the latter. *Manilal Brijalal v. Gordhan Spg. and Mfg. Co.*, (1916) 18 Bom LR 982 : AIR 1916 Bom 147.

§ See also Notes under s. 111 under the heading "Court sale of shares".

Execution of transfer form by Income-tax Recovery Officer.—Where the Tax Recovery Officer is required to transfer shares to a person who has purchased them, the Tax Recovery Officer may execute such documents or make such endorsement as required and in that event the execution and the endorsement made shall have the same effect as. executed by the party. *Swadeshi Polytex Ltd. v. Swadeshi Mining & Manufacturing Co. Ltd.*, (1987) 62 Com Cases 683 (All).

Specific performance of agreement to sell shares

An agreement to sell shares is capable of being specifically enforced. This is the considered opinion of the Bombay High Court as expressed in its decision in *Brooke Bond India Ltd. v. U.B. Ltd.*, (1994) 79 Com Cases 346 (Bom). The agreement was for the sale of a majority shareholding of the seller. The agreement was performed in part by putting a nominee of the buyer on boards of the companies concerned. A sum of money by way of earnest was paid and accepted and incorporated in the agreement. The agreement provided for payment of the balance within thirty days after all the approvals required for effecting the sale, transfer and delivery of the shares were completed. The balance of the purchase was to be adjusted to the fluctuations, if any, in the net worth of the company. There was a provision that if the seller defaulted he would refund the earnest money with 18% interest. Subsequently the agreement was confirmed under intimation as to the net worth of the company, indicating also the total consideration. Subsequently still the buyer learnt that the seller was proposing the sale to some other person. The buyer put that other person under notice and brought an action for specific performance and interim reliefs. The seller's arguments were defeated. The agreement was for the sale of shares in its substance and the sale of shares even if they carry the controlling interest does not amount to a sale of the undertaking of the company so as to require the approval of the shareholders under section 293(1)(a). The court did not agree with the contention that the consideration for the sale was vague. The letter confirming the transaction indicated the networth as well as the sale consideration. The provision for refund of earnest money does not by itself militate against specific enforcement. Nor the court was prepared to believe that seasoned businessmen would enter into a contract of transfer of shares in a bulk of companies in which they had a controlling interest unless they knew that they would be capable of fulfilling the terms of the contract. The fact that the purchaser was a company and, therefore, it would have to fulfil the formalities of section 372 as to inter-corporate investments such as a special resolution and approval of the Central Government, was also of no consequence. Section 372 would come into play at the stage of actual investment and not at the stage when there is only an agreement to invest. The absence of those formalities at the stage where the seller is only to be restrained from not committing breach of the agreement was not relevant. That was not the stage at which the agreement could be declared to be null and void.

Specific enforcement of time bound agreement for transfer of shares.—Where the nature of the shares under transfer is such that their value is, as a matter of fact, volatile, it would be natural to hold that in such an agreement the time of delivery is of the essence. But even so the court said that some marginal delay caused by the fact that the company issued share certificates belatedly was not sufficient to enable the other party to walk out of the agreement on the ground that the failure to keep the date for completion amounted to a total breach of the agreement. The failure of the company to fulfil its statutory duty to issue share certificates within the prescribed time was rectified by the company thus enabling both parties to perform their contract. The court allowed relief by way of specific enforcement. *Grant v. Cigman,* (1996) 2 BCLC 24 (Ch D). The courts have been holding since long with regard to contracts for sale of shares that the time is of the essence both at law and in equity because shares continually vary in prices from day to day. *Schwabacher, Re,* (1907) 98 LT 127 at 129.

Accordingly, where there is a provision for the purchase of shares on payment by a stated date, it is to be presumed, in the absence of any contrary indication, that the parties to such a contract have impliedly stipulated and mutually intended that the time of payment shall be of the essence. *Hare v. Nicoll,* (1966) 1 All ER 285, 294. It has been said about these statements that they are too general and are likely to be confined to the shares of trading companies only. (*Grant v. Cigman*) (*Supra* at p. 31).

Transfer of shares held in trust.—Where the corpus of a trust consisted of shares in a company which were put under trust for 99 years and the beneficiery of the trust was seeking transfer of shares in his own name without showing any breach of trust on the part of the trustees, the Court refused to grant an injuction for staying the transfer. The parties to the dispute admitted that the matter in dispute was a part of the struggle for the control of the company. *Manisha Commercial Ltd. v. N.R. Dongre,* (2000) 101 Com Cas 106 (Del). In another litigation between the same parties, *Manisha Commercial Ltd. v. N.R. Dongre,* (2003) 115 Com Cases 1010 (Delhi), the Court said that in a suit for declaration that the trustee in respect of the trust shares should vote in accordance with the wishes of the beneficiary, an application for restraining the company from alienating or disinvesting certain shares was outside the scope of the suit and, therefore, could not be granted. A relief which cannot be granted in the suit cannot also be granted by way of interim injunction. There were no allegations of mismanagement by the Board of directors. The company could not be restrained from carrying on its normal business activities including disinvestment of shares.

Transmission of shares [second proviso to sub-s. (1) and Arts. 25 to 28, Table A]

The effect of the second proviso to sub-section (1) is that it enables a company to register as shareholder a person to whom the right to any shares has passed by transmission, by operation of law, and that the provisions relating to transfer of shares do not apply to cases of transmission by operation of law. There need be neither an instrument of transfer nor any payment of stamp duty. But the discretion of a company to insist upon the proof to transmission and the power to regulate by articles the procedure relating to recognition of transmission are not affected. See also *Life Insurance Corporation of India v. Bokaro & Ramgur, Ltd.,* (1966) 36 Com Cases 490 (Tribunal) (Delhi); *State of Orissa v. Indian Chemical Products Ltd.,* AIR 1957 Orissa 203; *Kamalabai (Smt.) v. Vithal Prasad Co. (P.) Ltd.,* (1993) 77 Com Cases 231, 238, 239 (Kar).

Where the articles of a company enabled members to transfer shares to their relatives or other members without sanction of the Board of directors and restricted only the right of transfer to outsiders, it was held that the restrictions as to transfer of shares could not be used to defeat a transmission. *Hemendra Prasad Barooah v. Bahadur Tea Co. Ltd.,* (1991) 70 Com Cases 792, 795 (Gau).

'Transmission by operation of law' is not a transfer. It refers to those cases where a person acquires an interest in property by operation of any provision of law, such as by right of inheritance or succession or by reason of the insolvency or lunacy of the share-

holder or by purchase in a Court-sale, while a transfer is effected by act of parties. *Cf. Maheshwari Khetan Sugar Mills v. Ishwari Khetan Sugar Mills,* (1963) 33 Com Cases 1142 (All). [**Reversed** on another point in (1977) 47 Com Cases 185 (SC)]; *Indian Chemical Products Ltd. v. State of Orissa,* (1966) 36 Com Cases 592 : AIR 1967 SC 253; *Hemendra Prasad Barooah v. Bahadur Tea Co. Ltd.,* (1991) 70 Com Cases 792, 795 (Gau).

In an application under S. 38 of 1913 Act [C.A. 1956, S. 108] all the relevant papers to determine the question of title involved in the case were filed by the parties. The question of title was not of any complicated nature. On the Annexures filed, the petitioner succeeded in establishing his title by operation of law to the shares in question. The petitioner also lodged a proper deed of transfer with the company. The Annexures disclosed that the action of the Board of directors in refusing to register the petitioner in the register of the company as a shareholder was not *bona fide* and was not for sufficient cause. It was held that the petitioners' name was to be registered in the register of shareholders of the company. *State of Orissa v. Indian Chemical Products Ltd.,* AIR 1957 Ori 203 at 212.

Where the person or persons to whom any shares have been transmitted by operation of law, do not get the shares registered in their own names, as shareholders, they will not be entitled to exercise voting or other rights nor receive dividends on the shares. But at the same time, it should be noted, any dues on the shares such as call amounts may be enforced against them in their capacity as legal representatives of the deceased shareholder. See, *Thenappa Chettiar v. Indian Overseas Bank Ltd.,* (1943) 13 Com Cases 202 (Mad).

The question of the legal representative of deceased shareholder becoming entitled to the shares arises only in the case of a sole shareholder. Hence heirs of a deceased joint holder cannot become the holder of such shares by virtue of the above Regulations of Table A of Schedule I. *Ram Govind Misra v. Allahabad Theatres Pvt. Ltd.,* (1989) 66 Com Cases 358 (All).

The executor or administrator of a deceased shareholder or the trustee in bankruptcy of an insolvent shareholder has a right to claim registration in his own name without any qualification being indicated as to his position. *Re, Key (W.) & Sun Ltd.,* (1902) 1 Ch 467; *Re, Saunders (T.H.) & Co.,* (1908) 1 Ch 415. See also *Scott v. Frank F. Scott (London) Ltd.,* (1940) 3 All ER 508. He has only to produce a succession certificate. A succession certificate can be granted not merely in respect of a debt but also in respect of securities such as shares in a company and where a succession certificate has been granted in respect of such shares the company cannot insist on the production of probate or letter of administration. The certificate affords full indemnity to the company. *Thenappa Chettiar v. Indian Overseas Bank Ltd., (Supra).* Such remedy was also allowed in *Kamalabai v. Vithal Prasad Co. P. Ltd.,* (1993) 77 Com Cases 231 (Kar) where the court reiterated that no formalities like transfer deed, execution, attestation and stamp duty are needed in the case of a transmission. Legal heirs as shown by the succession certificate are aggrieved persons within the meaning of section 111(4) and, therefore, they are entitled to seek relief against the refusal.

In *Narinder Kumar Sehgal v. Leader Valves Ltd.,* (1993) 77 Com Cases 393 at 398 (CLB), though the deceased shareholder's will was filed with the company by his five sons, a telegram received by the company from a daughter set in motion a controversy regarding the identity of the legal heirs and though, under the proviso to section 108(1)(c), the company had the power to register as member any person to whom the shares had been transmitted by operation of law, the company was held to be well within its powers to insist on the production of succession certificate or probate or letter of administration. The CLB **relied** on in *Kasi Viswanathan Chettiar v. Indo-Burma Petroleum Co. Ltd.,* (1936) 6 Com Cases 42 : AIR 1936 Rang 52. Where it was held that even in the case of a succession under Mitakshara School of Hindu Law the legal heirs would have to produce a Certificate of Succession.

The managing director of a company, taking advantage of his position, transferred the shares of a deceased member in his wife's name. Together with such shares and the rights issue made thereafter he consolidated his position of majority control. The articles of the company carried a clause that transmission would be effected only on the basis of a succession certificate. The company had received neither any succession certificate nor family settlement about the shares. The court said that the act in question constituted an oppression of the real successors. The company was directed to register the shares proportionately in the names of legal heirs. *A.J. Coelho v. South India Tea & Coffee Estates Ltd.*, (2001) 33 SCL 503 : (2001) 45 CLA 17 (CLB—Chennai PB).

Where shares were left by a deceased shareholder under his will and the will, as duly probated, covered the shares in question, the CLB ordered registration of the shares in the name of the legatees but also added that they would be bound by the outcome of a civil suit for revocation of the probate which was pending at the material time. *Sanjeev v. Pereva and Roche (P.) Ltd.*, (2002) 110 Com Cases 717 : (2002) 38 SCL 203 (CLB).

If the company still refuses the transmission the remedies of the transmittee are the same as those of a transferee under S. 111, *Life Insurance Corporation of India v. Bokaro and Ramgur Ltd.*, (1966) 36 Com Cases 490 (Del); *Hanuman Mills (P.) Ltd. Re*, (1977) 47 Com Cases 644 (All). When the Estate Duty Act was in force, Bombay High Court had given the ruling that the company was not prohibited from registering a transmission without certificate from the Controller of Estate Duty. *Killick Nixon Ltd. v. Dhanraj Mills (P.) Ltd.*, (1983) 54 Com Cases 432 (Bom); *Shakuntala Rajpal v. Mckenzie Philip (India) P. Ltd.*, (1986) 60 Com Cases 545 (Del).

Article 25 of Table A provides that on the death of a member, the survivor or survivors where the member was a joint holder, and his legal representatives where he was a sole holder, shall be the only persons recognised by the company as having any title to his interest in the shares. If a company adopts a provision of this kind then in the case of death of a joint holder, the other joint holder or holders are the only persons entitled to be registered as members, excluding even the legal heirs of the member. It is observed in HALSBURY'S LAWS OF ENGLAND, 327 (Vol. 7(1), 4th Edn., 1988): para 518, p. 380 (Vol. 7(1)), 4th Edn., 1996 (Reissue) that unless the articles otherwise provide, the survivor or survivors of registered joint holders of shares are alone entitled to and liable upon such shares, even where one of the joint holders is a corporation. *Re, Maria Anna and Steinbank Coal and Coke Co., Maxwell's* case, *Hills's* case, (1875) LR 20 Eq 585. Nothing in the article shall release the estate of a deceased joint holder from any liability in respect of any share which he had held jointly with others (*Ibid*); *Law Guarantee and Trust Society Ltd. and Hunter v. Governor & Co. of Bank of England*, (1890) 24 QBD 406; and see *Re, Thompson's Settlement Trusts, Thompson v. Alexander*, (1905) 1 Ch 229.

There is however a decision of the Company Law Board, *Kamala V. Pai v. Esso Standard Refining Co. of India Ltd. (afterwards Hindustan Petroleum Corpn. Ltd.)* (Appeal No. 1 of 1977 order dated Feb. 23, 1977) : (1997) 3 Comp LJ 138 (CLB), to the effect that the heirs of a deceased joint shareholder are entitled to be registered as members jointly with the surviving joint holder.

In the case of the death of a member of an undivided Hindu Mitakshara family, holding shares in his name, this clause does not apply. See *Mohideen Pichai v. Tinnevely Mills Co.*, AIR 1928 Mad 571 (at 575, 577); but see *Thenappa Chettiar v. Indian Overseas Bank*, AIR 1943 Mad 743 : (1943) 13 Com Cases 202.

A company may make provision in its articles that in the event of insolvency of a shareholder, his shares are to be sold to particular persons, at particular price, to be determined in a fair manner. *Borland's Trustee v. Steel Bros. & Co.*, (1901) 1 Ch 279; *Wise v. Lansdell*, (1921) 1 Ch 420.

On the true construction of the article the effect of the provision is that the legal representatives may not exercise rights on their own behalf, they can still exercise them on behalf of the estate. *Llewellyn v. Kasintoe Rubber Estate Ltd.*, (1914) 2 Ch 670.

While the company is bound to recognise legal representatives of the deceased shareholder for transmission of shares as required by Article 25, Article 26 provides that the Board of directors may seek such evidence as it may consider necessary for convincing it that the applicants are genuine representatives and only then to accept them to membership. Relief can be had from the Company Law Board in this respect. *Debashish Dutta v. B.G. Somadder & Sons P. Ltd.*, (2002) 49 CLA 363 (CLB) : (2002) 38 SCL 154.

Transmission in case of sole owner.—On the death of a sole owner of shares, vesting of rights and liabilities goes in favour of the legal heirs. They are entitled to be registered as the holders of the shares. *Scott v. Scott (London) Ltd.*, (1940) Ch 794; *Safeguard Industrial Investments Ltd. v. National Westminster Bank Ltd.*, (1980) 3 All ER 849. But the legal heirs do not by itself become members of the company. The company cannot register them as members without their consent. *Re, Cheshire Banking Co. Duff's Executor's* case, (1886) 32 Ch D 301. A company cannot compell them to become member nor it is a duty to do so. *State of Kerala v. West Coast Planters Agencies Ltd.*, (1958) 28 Com Cases 13 (Ker).

The company can justifiably register them as members when they apply for it. *Buchan's* case (1879) 4 App Cas 549, 588; see also *Re, Jermyn Street Turkish Baths Ltd.*, (1971) 3 All ER 184, where PENNYCUICK J. observed that no particular form is required by statute for the registration of personal representatives, and, unless provided otherwise by the articles, all that is needed is a "distinct and intelligent request" to that effect.

Where fourteen years had passed since the death of the shareholder and there was no counter claim about the shares from any quarter, the CLB ordered the transmission of the shares to the shareholder's son on his complying with the requirements. *Kailash Narayan Bhangadia v. V.S.T. Industries Ltd.*, (1998) 93 Com Cases 470 : (1997) 2 Comp LJ 254 (CLB—SB).

Out of the shares left behind by the deceased member, the company transmitted about half of them to the legal heir on the basis of the knowledge already possessed that she was the genuine legal heir. But for the rest of the shares the company insisted upon production of a succession certificate or probated will. The Company Law Board held that the company had lost the right to do so and ordered registration of all the shares in the name of the successor. No other perosn had lodged any claim or objection. *Nandita Bhardwaj v. Sapphire Machines P. Ltd.*, (2000) 2 Comp LJ 109 (CLB).

If the representatives accept a new issue of rights shares they will be personally liable to pay for them. *Re, Leeds Banking Co., Fearnside and Dean's* case, *Robson's* case, (1865) LR 1 Ch 231. This is so because the company has to give them a clear registration without any reference to their representative capacity. They have the right to ask the company by their own agreement the order in which their names should be registered. *Re, Saunders & Co.*, (1908) 1 Ch 415. Such a registration is not a transfer and therefore the instrument of transfer is not necessary. The company is bound to accept the succession certificate if they are legal heirs or having letters of probate, if they are coming under a will or letter of administration, if they are coming as executor or under a court order, if they are coming as liquidators of a company or as trustees or assignee or receivers of an insolvent member. One of the two executors registered as shareholders cannot transfer; all must concur. *Secretary of State v. Parijat Devi*, 63 IA 61 at 69; *Barton v. North Staffordshire Ry.*, (1888) 38 Ch D 458; *Barton v. L. & N.W. Ry.*, (1889) 24 QBD 77. Executors can transfer to one of themselves. *Grundy v. Briggs*, (1910) 1 Ch 444.

Order of transmission for assuring company's functioning.—A private company pleaded inability to hold a board meeting because it was a two-shareholder-two director company and one of them had died. An application was made to the Company Law Board by the sole surviving director for a direction that an extraordinary general meeting be convened with the surviving shareholder constituting as quorum. The CLB adopted the alternative method of meeting the predicament. It directed that the son of the deceased member be deemed to be a member for purposes of transmission and convening of meeting. There would be no need then of invoking s. 186 for directing a meeting with one

shareholder present. *Débashish Dutta v. B.G. Somadder & Sons P. Ltd.,* (2002) 38 SCL 154 : (2002) 49 CLA 363 (CLB).

Shares held by Karta of Joint Mitakshara Hindu family.—In case of shares, (shares in joint stock companies which stand in the name of the *Karta* of a Joint Mitakshara Hindu Family) the Companies Act and the Articles of Association of the company, in the present case, make it abundantly clear that the legal title in the shares is in the holder of the shares *viz.*, the *karta* of the joint family. On his death, the executors or administrators of the deceased holder of the shares "shall be the only person recognised by the company as having any title to the shares". The position, therefore, is that on the death of the *karta* who was the registered holder of the shares, the title to the shares *vis-a-vis* the company, did not on his death pass by survivorship to the surviving members of the coparcenary of which the deceased was the *karta*. The exceptions in cases of a Hindu dying intestate occurring in ss. 211(2), 212(2) of the Indian Succession Act, 1925 do not therefore apply in such cases. Accordingly, neither the principles of Hindu Law nor the provisions contained in the Succession Act, stand in the way of grant of Letters of Administration limited to the shares held by the *karta* of a joint Mitakshara Hindu family in the event of his dying intestate. *Goods of Sew Prasad Saraf, Re,* AIR 1954 Cal 444 at 445.

Where shares have been purchased by the *karta* of a joint Hindu family out of joint family funds, and are registered in his name, on his death, the person who is entitled to be registered as owner is the succeeding managing member of the family. *Piari Lal v. Muir Mills Ltd.,* AIR 1919 All 619.

If the legal heirs *etc.* do nothing in the matter, the directors can under Art. 28 proviso of Table A call upon them to make up their mind within ninety days whether they will transfer the shares or register themselves. If they do not comply with the notice, payment due on the shares may be withheld until compliance. As to the formalities of transmission, see, *U.T.I. v. Om Prakash Barlia,* (1983) 54 Com Cases 723 (Bom); *Killick Nixon Ltd. v. Dhanraj Mills (P.) Ltd.,* (1983) 54 Com Cases 432 (Bom).

Pre-emptive provision in articles and its effect on right of transmission.—Where the articles restricted the transfer to a prescribed class and required the directors to arrange for a transfer within that class within a time limit, the effect would be that on the directors' failure to find a purchaser within that class at a fair value within the time delimited, the member would get an absolute right to transfer his shares to whomsoever he liked. Applying these principles to the case of a transmission, the court said that the period of three months would start running from the date on which the company was formally notified of the death of a member and a note to that effect was entered in the company's share register. On the expiry of three months (the prescribed period) from that date the personal representatives for the time being became entitled either to transfer the shares or to be registered themselves free from any restrictions in the company's articles by virtue of the grant of letters of administration. Alternatively, the court said that if the matters are to be taken from the date on which the representative applied to be registered and on the company's failure to accept the transfer within two months would get the right to apply for rectification of the register of members, that time had also run out because there was no effective exercise by the directors of their power to refuse since there were no validly appointed directors of the company. Two directors had retired by rotation and only one remained in office. A meeting attended by him alone would not be valid because none of the exceptional situations in which one-member meeting is valid were applicable. Where under the articles or statutory provisions one-third of the directors have to retire and at the crucial time there is only one director in office, he would retire. Members of the company could have rectified the situation either formally or under consent of all the corporators, but even that had not happened in this case. The representative became entitled to be registered under both the courts. *New Cedos Engineering Co., Re,* (1994) 1 BCLC 797 (Ch D).

Transmission of shares to widow.—On the death of a shareholder, his widow applies for transmission of the shares standing in the name of her deceased husband without producing a succession certificate and accepting in lieu thereof an indemnity bond. If the articles of association of the company provide that the directors in their absolute discretion may dispense with the production of succession certificate, probate or letter of administration upon such terms as to indemnity as the directors may consider necessary, the Board may transmit the shares to the widow of the deceased by obtaining an indemnity bond.

The Court of Appeal has noted that there is a distinction well recognised in company law between the transfer of shares and their transmission on death. PETER GIBSON LJ said that in approaching the question of construction of the company's articles the court is to be guided by general considerations that the shares being the personal property are *prima facie* transferable and if the right to transfer is to be taken away it would have to be done by language of sufficient clarity in the articles. The articles in question were not capable of being so construed because the only provision in the articles was that on the death of a member the directors' power to refuse transmission would be the same as in the case of transfer and, therefore, it was held that the director's decision to refuse the transmission was wrongful. The court ordered rectification of the register of members for including transmission of the shares to the widow. *Stothers v. William Steward (Holdings) Ltd.*, (1994) 2 BCLC 266 (CA).

Transmission of joint holdings.—Where shares are registered in joint names and the articles of the company provide that the survivor shall be the only person to be recognised by the company as having any title to or interest in shares, the company is justified in refusing to register the transmission of title by operation of law in favour of the son of the deceased holder even though he may obtain succession certificate from the Court and the schedule to the certificate also includes the shares mentioned above. The company is concerned with the legal right of the holder only and not the equitable right to ownership. If the son of the deceased holder can establish his title of ownership in court and obtain a court order to transfer the holding of the joint holder to the joint names of the joint holder and the son of the deceased, the company has to comply with the direction.

The question of the legal representative of deceased shareholder becoming entitled to the shares arises only in the case of a sole shareholder. Hence heirs of a deceased joint holder cannot become the holder of such shares by virtue of Regulations 25 of Table A of Schedule I. *Ram Govind Misra v. Allahabad Theatres Pvt. Ltd.*, (1989) 66 Com Cases 358 (All).

The registration of the shares by a company in the name of the surviving joint shareholder was held to be justified even though the legal heirs of the deceased joint holders were claiming ownership of the shares in question. *Jayalakshmi Acharya v. Kal Electronics and Consultants (P.) Ltd.*, (1997) 90 Com Cases 200 : (1997) 3 Comp LJ 135; *Kamala Pai v. Esso Standard Refining Company of India Ltd.*, (1997) 3 Comp LJ 138 (CLB–N.Delhi) the joint shareholder had disclaimed his interest in the shares and, therefore, on the death of the deceased joint-holder, interest in the shares devolved on the legal heir of the deceased.

Acquisition of assets does not operate as transmission.—A person cannot claim the benefit of this section just by showing that he has acquired the assets of a company. Such a transaction is not a transmission of shares, nor does it have the effect of taking over the shares of the company's members. There ought to be a full formal transfer of the shares to the person acquiring the assets, and he should get the transfer registered with the company after satisfying the requirement of S. 108. *Lalithamba Bai v. Harrisons Malayalam Ltd.*, (1988) 63 Com Cases 662 (Ker). On appeal the court presumed from the peculiar circumstances of the case that full and formal transfer might have been there and therefore the petitioners were entitled to have their shares entered in the register of members of the company *Lalithamba Bai v. Harrisons Malayalam Ltd.*, (1997) 13 SCL 175 (Ker).

Power to refuse transmission.—The power to refuse transmission must be there in the company's articles. The articles provided power of absolute refusal of a transmission for the Board. The CLB observed that such discretion has to be exercised in a *bona fide* manner in the interests of the company. A shareholder left his shares under his will to his son. The son was known to be an undesirable person. It was a closely held company. The admission of an unacceptable person might cause disharmony. It was held that the refusal to permit transmission in favour of the son was a *bonafide* decision in the interests of the company. The company was directed to arrange for purchase of the shares by other members. *Xavier Joseph v. Indo-Scottish Brand P. Ltd.*, (2002) 110 Com Cases 706 (CLB).

Company's lien on shares [Arts. 9 to 12, Table 'A']

Lien on shares is a subject-matter which has to be dealt within the company's articles. Articles 9 to 12 of Table A carry the rules as to lien in their model form. These articles are not compulsory. A company may adopt its own articles either originally or subsequently by a special resolution. The fact to be noted is that unless the articles provide for a lien, a company has no inherent or *prima facie* right of lien on the shares of members. *Canara Bank Ltd. v. Tribhuvandas Jetha Bhai,* AIR 1957 Trav Co. 183 : (1957) 27 Com Cases 647. It was pointed out in the same case that while article 9 of Table A talks of a lien on shares not being fully paid, it is open to a company to adopt its own articles which give it a lien on fully paid shares also as regards any money due to it from the shareholder. *Chotanagpur Banking Assn. Ltd. v. Rajib Nath Mukherji,* (1947) 17 Com Cases 17 (Pat). But in the case of a public company, one of the requirements with respect to the listing of securities on a recognised stock exchange is that the articles of the company shall provide that the fully paid shares will be free from all lien, while in the case of partly paid shares the company's lien will be restricted to monies called or payable at a fixed time in respect of such shares (Rule 19(2)(ii) of the Securities Contracts (Regulation) Rules, 1957). The usual form of lien is to declare that the company shall have first and paramount lien on the shares of each member for his debts and liabilities to the company, whether matured or not. Such a provision is fully effective for private as well as public companies. *New London, etc. Bank v. Brocklebank,* (1882) 21 Ch D 302; *Bradford Banking Co. v. Briggs,* (1886) 12 App Cas 29. Lien can be created outside the articles under a private agreement with a member. *Re, Kingstown Yacht Club,* (1888) 21 LR Ir 199; *Allen v. Gold Reefs of West Africa Ltd.*, (1900) I Ch 656 (CA).

Where no express lien is conferred, but shares may be forfeited if money due in respect of them is not paid, the company has no lien: *Re, Dunlop, Dunlop v. Dunlop,* (1882) 21 Ch D 583 (CA); *Re, Kingstown Yacht Club,* (1888) 21 LR Ir 199. Where lien is acquired by a subsequent amendment of the articles, it will not allow the company to upset any rights which might have been acquired *e.g.*, under Insolvency laws, on the shares of a particular member *Re, Rowe, Ex. p., West Coast Gold Fields Ltd.*, (1904) 2 KB 489. But otherwise the right of lien subsequently brought in shall be binding on all the members even if they became shareholders before the alteration. *Allen v. Gold Reefs of West Africa Ltd.*, (1900) 1 Ch D 656 (CA). The right of lien created by an amendment of the articles cannot be used to justify refusal to register a transfer shares which has already been presented and which could not be refused in the absence of a lien. *McArthur v. Gulf Line Ltd.*, 1909 SC 732. Private company can adopt a rider lien so as to create a first and paramount lien for all monies presently payable by the shareholder or his estate to the company. The latter words are of much wider ambit. They cover trading debts and other liabilities of shareholders to the company provided that they are payable at the time that the lien is being exercised. It is possible for private companies to word this article even wider, *e.g.* "all moneys or liabilities whether presently due or due at a future date or due subject to a condition or contingency," but the use of such wide liens is not general. It is important, however, to realise that, if the articles so provide, the company's lien may secure claims of a private company other than those for calls on shares. The lien is limited to moneys owed by the shareholders to the company and does not secure, for exam-

ple, a guarantee by the shareholder in favour of preference shareholders to meet their dividends. *Stark v. Fife & Kinross Coal Co.*, (1899) 1 F 1173 : 7 SLT 130. But the lien under article 11 of the Table A has been held to apply to a director's loan account which covered bills paid on his behalf by the company. *Champagne Perrier-Jouet S.A. v. H.H. Finch Ltd.*, (1982) 3 All ER 713.

Regulation 10 of Table A, Sch. 1 requires that the exercise of the right of lien and sale of member's shares in that exercise would require a presently payable debt from the member and a minimum of 14 days' notice in writing demanding payment. In this case no notice was given and the dues claimed by the company were also disputed by the member. The forfeiture of shares in the exercise of the right of lien and their disposal were both held to be void. The transferee would get no rights under such a transfer but he would be entitled to refund of money paid by him. *T.M. Paul (Dr.) v. City Hospital (P) Ltd.*, (1999) 35 CLA 164 (Ker).

Extent of lien.—The right of lien extends to any monies receivable by the shareholder in respect of the shares even in the winding up of the company. *Amarnath Goela v. Karnal Electric Supply Co. Ltd.*, AIR 1952 Punj 411. *Re, General Exchange Bank, Re, Lewis*, (1871) 6 Ch App 818. The right of lien was allowed to be enforced against the money due under a guarantee given by the shareholder in respect of a customer's indebtedness. *Kanhaiyalal Janwar's* case, (*Infra*). A lien on the proceeds of sale of shares is a lien on the shares : *Deering and McQuestron v. Hibernian Joint-Stock Banking Co.*, (1868) 16 WR 578.

A debt in respect of which lien exists is not affected by any bar of limitation, if, under the articles, the lien can be enforced otherwise than through the Court. Thus Limitation Act bars only the remedy by suit in a court of law and does not extinguish the debt if it can be realised by enforcing the lien by exercise of any power of sale or otherwise which may be contained in the articles. *Unity Co. (P.) Ltd. v. Diamond Sugar Mills*, AIR 1971 Cal 18; *Chotanagpur Banking Assn. Ltd. v. Rajib Nath Mukherji*, (1947) 17 Com Cases 17 (Pat).

The lien prevails over a pledge, of which notice has not been given to the company: *Kanhaiyalal Janwar v. Pandit Shirali & Co.*, AIR 1953 Cal 526 : (1953) 23 Com Cases 399. Where such notice is given the company's lien would become postponed. *Bradford Banking Co. v. Briggs, Son & Co. Ltd.*, (1886) 12 App Case 29 (HL).

Where the articles of association of a private limited company gave the company a first and paramount lien over the shares of any shareholder indebted to it, and the shareholder created an equitable charge on the shares in favour of a third party, the company's lien was held to have priority over the equitable charge. *Champagne Perrier-Janet S.A. v. H.H. Finch Ltd.*, (1982) 3 All ER 713. It is doubtful whether there is such a thing as an equitable charge in India but it is submitted that even if a legal charge had been created in respect of the shares, the company's lien would still have had priority, as a company is not bound by any dealings with shares which are contrary to its articles of association and can refuse to register a transfer which does not conform to the requirements of the articles.

The company can waive the lien either expressly or by doing anything which has the effect of waiving the right. See *Northern Assam Tea Co.*, (1870) 10 Eq 458; *Bank of America v. Salisbury Gold Mining Co.*, 1892 AC 281. Where the articles give a lien against the "holder" of any shares and the holder is a trustee, the company cannot claim a lien for debts due from the *cestue que trust, Re, Perkins*, (1890) 24 QBD 613. Nor can the company alter the register of shareholders by substituting the name of the beneficiary in the place of the trustee, in order to enable it to enforce the lien against the beneficiary. *Re, Ystalyfera Gas Co.*, 1887 WN 30.

Waiver of lien.—Where a company registers a transfer of shares over which it has a lien, the registration will operate as a waiver of the lien. *Turner Morrison & Co. Ltd. v. Hungerford Investment Trust Ltd.*, (1972) 42 Com Cases 512 : AIR 1972 SC 1311.

Where a company has notice of a trust and a lien in its favour was in respect of a subsequent transaction, it was held that the lien could not prevail. *Wigan Coal & Iron Co.*, (1916) 2 Ch 293.

In *Kanhaiyalal Janwar v. Pandit Shirali & Co.*, AIR 1953 Cal 526 : (1953) 23 Com Cases 399 at 408, 409 (Cal) it was held that if a person having a contractual lien creating an equitable charge in his favour accepts a pledge of the goods over which he has the lien, the lien disappears by waiver, for the pledge is a higher security than the equitable charge and the acceptance of it implies an intention to give up the lower security. In order to have this effect, the pledge must have been created, or to put it in the language of that passage, "the new arrangement must in fact be carried out" Citing HALSBURY Vol. VII, Page 204 (3rd Edn.). Now, in the present case, there was only an agreement to pledge which had never been carried out. The pledge had never in fact been made in terms of the agreement to make it. It could not be said that a mere agreement to take a pledge amounts to a waiver of the existing lien. In the Patna case there may have been waiver because an order for sale had actually been made expressly providing that the sale would be without any incumbrance. *Chotanagpur Banking Assn. Ltd. v. Rajib Nath Mukherjee*, (1947) 17 Com Cases 17 : AIR 1948 Pat 443.

Enforcement and postponement of lien.—The usual method of enforcing a lien is a refusal by the company to register a transfer of shares until the dues of the company in respect of those shares are first paid.

Where the articles of a company contain a provision that the company may decline to register a transfer of shares by a member who is indebted to the company, such a provision may amount to a passive lien on the shares to the extent of the indebtedness; but it will not prevail over an equitable charge created by the shareholder. See *Bank of Butterfield & Sons Ltd. v. Golisky*, 1926 AC 733; *Unity Company Private Ltd. v. Diamond Sugar Mills*, AIR 1971 Cal 18.

An article merely giving a right of lien is not enough to confer a right to bring the property to sale in exercise of such right. *See Bank of India Ltd. v. Rustom Fakirji*, AIR 1955 Bom 419.

A lien cannot be enforced by forfeiture, even if the articles provide that it may be so enforced. For, a lien is in the nature of an equitable mortgage and a clause for forfeiture in a mortgage is invalid as a clog on the equity of redemption. *Cf.* PALMER'S COMPANY LAW, 24th Edn., para 41.15: para 8.820, 25th Edn., 1992. *Hopkinson v. Mortimer Harley & Co.*, (1917) 1 Ch 646.

In the absence of a provision in the articles giving power to the company to enforce a lien by sale, the lien cannot be enforced except through court. *New London & Brazilian Bank v. Brockle Bank*, (1882) 21 Ch D 302. A lien cannot be enforced by the company by selling the shares which are under its lien unless there is a clear power to that effect in the company's articles. A power in the nature of the rule stated in Art. 10 of Table A would be necessary. According to this article the Board of directors may sell the shares on which the company has a lien in the manner the directors may think fit provided that shares shall not be sold unless the sum in respect of which the lien exists is presently payable or until the expiration of fourteen days after a notice in writing demanding payment of the amount which is presently payable has been given to the registered holder or the person entitled to the shares by reason of the holder's death or insolvency.

Where under the company's articles the power to sell existed, it was held that the company would have a lien at law on the share scrips, and an equitable charge on the shares if the scrips were not in the possession of the company. The articles provided for the sale of shares which were subject to lien only. The company had the right to sell only those shares whose scrips were in the possession of the company. With respect to shares subject only to an equitable charge the right of the company to sell the shares could only be enforced by a suit, and a private sale held by the directors of such shares was invalid. The court also held that the amounts taken from the company by the managing director on

account from time to time represented a loan and was a debt "presently payable" even before demand, and in respect of such a debt the company could enforce its lien on the shares held by the director, without making a demand. *Albert Judah Judah v. Ramapada Gupta,* (1960) 30 Com Cases 582 at pp. 601, 602 (Cal); *Unity Company P. Ltd. v. Diamond Sugar Mills,* (1970) 2 Comp LJ 64 (Cal).

The sale of shares is like an ordinary transfer of shares and therefore requires the execution of a transfer deed. In the absence of a proper instrument of transfer it would not be lawful for the company to register the transfer. *Albert Judah Judah* at p. 640 (*Supra*).

Article 11 further provides that to give effect to any such sale the court may authroise any person to transfer the shares and to execute the necessary documents. The purchaser will get a good title in spite of any irregularity or invalidity in the proceedings in reference to the same. The proceeds of the sale shall be received by the company and applied in payment of such part of the amount in respect of which the lien exists as is presently payable. The residue, if any, shall subject to a like lien for sums not presently payable as existed upon the shares before the sale, be paid to the person entitled to the shares at the date of the sale.

A sale of shares in the enforcement of the company's right of lien cannot be questioned on the ground of the directors' motives if the sale was in the interest of the company. It would however be questionable where the sole motive was not to benefit the company but to promote the private interest of the *de facto* directors. *Albert Judah Judah v. Ramapada Gupta,* (1960) 30 Com Cases 582 at 622 (Cal).

Priority of lien.—Priority of the company means that the rights generated by lien shall be prior rights in respect of the shares as against all other rights in favour of other persons in respect of the same shares *e.g.*, if the shareholder mortgages or charges the shares a company's right will be prior to that of the mortgagee or chargee. The company's priority will not apply in respect of money's which became due from the shareholder to the company after the company had received notice of a charge given to another person. *Bradford Banking Co. Ltd. v. Briggs, Son & Co. Ltd.,* (1886) 12 App Cas 29 (HL), **overruling** *Miles v. New Zealand Alford Estate Co.,* (1886) 32 Ch D 266 (CA); *Rearden v. Provincial Bank of Ireland,* (1896) 1 IR 532; *Mackereth v. Wigan Coal and Iron Co. Ltd.,* (1916) 2 Ch 293. In the *Bradford's* case (*Supra*) certain shares which were subject to a first and paramount lien were given to bank as security for an overdraft and the bank gave notice to the company, the court held that the bank's claim was prior to that of the company which arose subsequently.

Where a shareholder mortgaged his fully paid-up shares in a banking company by the deposit of the shares, and the mortgagee gave notice of the mortgage to the bank, claiming prior lien and the bank claimed, under its articles a first and paramount lien on these shares in respect of amounts due from the shareholder which had become due before receipt of the notice, It was held that the bank and not the mortgagee had a prior charge on the shares. *Canara Bank Ltd. v. Thribhuvandas Jatha Bhai,* (1957) 27 Com Cases 647 at 649 : AIR 1957 TC 183. Notice to the company means notice to any director or officer who is authorised in the matter. *United India Sugar Mills Ltd., Re,* AIR 1933 All 607; *Rainford v. James Keith & Blackman Co. Ltd.,* (1905) 2 Ch 147 (CA). The lien continues to exist although the shareholder has given the company unmatured bills for his debt; and it prevails over a charge given after the submission of the bills but before maturity. *Re, London, Birmingham and South Staffordshire Banking Co. Ltd.,* (1865) 34 Beav 332.

Loss and discharge of lien.—The company's lien is lost if it registers a transfer of the shares, which are subject to the lien. *Higgs v. Assam Tea Co.,* (1869) LR 4 Exch.; 387; *Re, Northern Assam Tea Co., ex. p., Universal Life Assurance Co.,* (1870) LR 10 Eq 458. A dividend declared after the execution of the document but before registration of the transfer shall be under the spell of the lien. *M'Murdo, Penfold v. M'Murdo,* (1892) 8 TLR 507. Where the company is a listed public company so that the purchaser of shares cannot be rejected by the company on any grounds whatever and the position was that the com-

pany was bound to accept the transfer, the court directed the company to accept the transfer and also pay the amount of dividend which had become due since the date of transfer and which was withheld by the company under its lien for claims against the managing director whose shares in question were transferred by the legal heirs after his death. *Ferrom Electronics P. Ltd. v. Vijaya Leasing Ltd.*, (2000) 36 CLA 327 (Kant).

Where a shareholder transfers a part of his shares on which company has a lien and company declines to register the transfer, the lien must as between the transferor and transferee be satisfied out of the remaining shares, if sufficient. *Gray v. Stone and Funnell*, (1893) 69 LT 282. A lien may be discharged by entering into a new agreement with the shareholder the terms of which are incompatible with the right to lien or which show an intention to waive the lien. *Bank of Africa v. Salisbury Gold Mining Co.*, (1892) AC 281 (PC); *Hunter v. Stewart*, (1861) 4 De GF & J 168. A lien is discharged when shareholder pays off the debt. He can then ask the company to transfer the lien in favour of his nominee. *Everitt v. Automatic Weighing Machine Co.*, (1892) 3 Ch 506.

Forfeiture of shares [Arts. 29 to 35 Table 'A']

Articles 30 to 35 of Table A deal with forfeiture of shares. They reproduce Arts. 24 to 30 of the previous Act and correspond to Arts. 18 to 22 of the English Act of 1985. The Articles of a company generally contain a provision for forfeiture of shares for non-payment of calls or instalments. A power of this kind is not inherent in a company because the ordinary right of a company is to file a money suit for recovery of the call amount. This power exists only where it is given by the articles and if it is not there it may be introduced by a special resolution. *Clarke v. Hart*, (1858) HLC 633; *Dawkins v. Antrobus*, (1881) 17 Ch D 615, 634; *Allen v. Gold Reefs of West Africa*, (1900) 1 Ch 656.

This power is vested in the directors and like all other powers of directors is a power of fiduciary nature to be exercised in good faith for the benefit of the company. The power must be formally exercised by a director's resolution unless the notice of forfeiture served upon a shareholder is itself in the shape of a resolution of forfeiture. *Prayan Prasad v. Gaya Bank and Traders Association Ltd.*, AIR 1931 Pat 44 : (1931) 1 Com Cases 85. There was no resolution of forfeiture in this case and the forfeiture being ineffective, the member remained liable as a contributory. One of the articles of association of a company authorised the directors to delegate any of their powers to committees consisting of such member or members of their body as they thought fit. It was held that a resolution for forfeiture of shares passed by such committee was not invalid. *Bhagwati Prasad v. Shirmani Sugar Mills Ltd.*, (1949) 19 Com Cases 286 at 291 (All). See *Pokharmal v. Flour and Oil Mills Ltd.*, (1934) 4 Com Cases 280 (where no resolution was passed as per articles). Where the format of the resolution was "shares be and are hereby forfeited provided the call money was not paid on or before a certain date" the resolution was held to be valid though it was prospective in nature. *Abdul Karim Babu Khan v. Sirpur Paper Mills Ltd.*, (1969) 39 Com Cases 33 (AP).

The effect of a forfeiture on the shareholder is that from the effective date of the forfeiture, he ceases to be a member of the company [Art. 33 Table A]. He loses not only the privileges and rights of membership but is also freed from the obligations of membership, particularly the duty to pay the call amount, though for one year period after forfeiture his name can be placed as a past member on the list of contributories in a winding up. There can be a provision in the articles that he would nevertheless remain liable to pay the call though that liability will be *qua* debtor and not *qua* member. *Naresh Chandra Sanyal v. Ramani*, (1945) 49 CWN 503. A shareholder cannot insist that forfeiture should be carried out even if he has been given notice of forfeiture. *Biggs case*, (1865) LR 1 Eq 309 : (1877) 5 Ch D 6787 (CA). A valid forfeiture holds good against the liquidator. *Dawes's* case (1868) LR 6 Eq 232. The requirements of a valid forfeiture are as follows:

***Bona fide* in interest of company.**—A forfeiture must be carried out only if it is in the interest of the company otherwise it would be regarded as collusive forfeiture made by the directors for the purpose of enabling a favoured member to escape from his liability.

This is an abuse of power and also a fraud on other shareholders. *Re, Esparto Trading Co.*, (1879) 12 Ch D 191; *Spackman v. Evans,* (1868) LR 3 HL 171, 186; *Lord Wallscourt's* case, (1899) WN 258. However, a reasonable compromise may be made with the defaulting shareholder. *Liquidator of General Property Investment Co. v. Craig,* (1891) 18 R 389. The power was not permitted to be exercised surreptitiously for the purpose of expelling a shareholder, nor by connivance for the purpose of assisting him in getting rid of his shares, *Kanshi Ram v. Kishore Chand,* AIR 1915 Lah 109 nor at the request of a shareholder to relieve him from liability. *Abdul Karim v. Sirpur Paper Mills,* (1969) 39 Com Cases 33 (AP).

Strict compliance with provisions relating to forfeiture necessary.—To constitute a valid forfeiture, there must be a special power given to the directors to forfeit, a proper notice to forfeit, and actual exercise of the power of forfeiture, according to the procedure marked out by the articles of the company. *Bhagwandas Garg v. Canara Bank Ltd.*, (1981) 51 Com Cases 38 (AP). *Clarke v. Hart (Supra). Sulochana Nathany v. Hindustan Malleables & Forgings Ltd.*, (2001) 1 Comp LJ 159 : (2001) 40 CLA 10 : (2001) 29 SCL 22 : (2001) CLC 448 (CLB—Cal—EB). Slight irregularity is as fatal as the greatest. *Kandurai Lakshmiah Chetty v. Adoni Electric Supply Co. Ltd.,* (1944) 14 Com Cases 63 (Mad); *Garden Gully, etc., Mining Co. v. McLister,* (1875) 1 App Cas 39; *Johnson v. Lyttle's Iron Agency,* (1877) 5 Ch D 687. Thus, if the call in respect of which the forfeiture is made is not validly made, or if the notice on which the forfeiture is founded is inaccurate in requiring payment of interest from a wrong date, *e.g.* the date of the call instead of the date appointed for payment, the forfeiture may be held invalid. *Garden Gully etc. Mining Co. v. McLister, Supra*; *Johnson v. Lyttle's Iron Agency, Supra*; *Watson v. Eales,* (1856) 23 Beav 294; *Faure Electric Accumulator Co. v. Phillipart,* (1888) 58 LT 525. A call which does not fix the time of payment cannot support a forfeiture, *Vishwanath Prasad Jalan v. Holy Land Cinetone Ltd.,* (1939) 9 Com Cases 324 : AIR 1939 All 739; *Bengal Electric Lamp Works Ltd., Re,* (1942) 12 Com Cases 238 : AIR 1942 Cal 516.

The basic features of a call, such as, the time and place of payment and the person to whom the payment was to be made, which were informally fixed by the directors and incorporated in the notice of forfeiture, the notice was held to be valid. *Mahalaxmi Textile Mills Ltd. v. Meyyappa Chettiar* (AK RM), (1949) 19 Com Cases 247 at 254, 255 (Mad—DB). Matters relating to service of notice, fixing of time and place of payment of arrears are only directory while the requirements relating to intimation of arrears of call money, interest and expenses, *etc.*, are mandatory, which, however, can be waived. *Abdul Karim Babu Khan v. Sirpur Paper Mills Ltd.,* (1969) 39 Com Cases 33 at 45 (AP). Where a shareholder is seeking to rescind his contract, the court can restrain a forfeiture. *Lamb v. Sambas Rubber, etc., Co.*, (1908) 1 Ch 845; *Jones v. Pacaya Rubber and Produce Co.*, (1911) 1 KB 455.

Shares may be forfeited if the company's articles specifically contain a power in that behalf. The shares of a group of shareholders cannot be forfeited because of alleged losses caused by the group. *Dilbhajan Singh v. New Samundri Transport Co. P. Ltd.*, (1985) 58 Com Cases 247 (P&H). The Court said at p. 253: "[The company may have some grudge against a particular shareholder if he has caused some loss to the company, but forfeiture of shares of all the shareholders without finding out or determining the individual liability and without giving separate notice to all of them, would certainly be illegal and improper. There is nothing on the record to show as to which individual shareholder was responsible for causing the loss, or whether the loss had occurred as a result of mismanagement or was it a loss in the ordinary course of business."]

The power of forfeiture must be exercised strictly having regard to the rules and regulations. *Travancore Electro Chemical Industries Ltd. v. Alagappa Textiles Cochin Ltd.*, 1972 Tax LR 2192 (Ker).

Forfeiture is treated strictly by the courts, and the Board of directors in trying to enforce it must strictly follow the procedure prescribed therefor. Even the slightest irregularity will be fatal to its validity. *Karachi Oil Products Ltd. v. Kumar Shree Narendra Singhji,* AIR 1950 Bom 149 : (1948) 18 Com Cases 215; *Public Passenger Service Ltd. v. M. A. Khader,* AIR 1962 Mad 276; See also *Promila Bansal v. Wearwell Cycle Co. (India) Ltd.,* (1978) 48 Com Cases 202 (Delhi).

Inclusion in the notice certain dues which were time barred did not affect the validity of the notice. *Bhagwati Prasad v. Shiromani Sugar Mills,* (1949) 19 Com Cases 286 (All).

The power of forfeiture must be exercised *bona fide* in the interest of the company. It should not be collusive or fraudulent. *Billerby v. Rowland & Co.,* (1902) 2 Ch 14; *Hall's* case, (1870) 5 Ch App 707. An illegal forfeiture cannot be validated by lapse of time or acquiescence, *Cf. Premila Devi v. People's Bank,* AIR 1938 PC 284 : (1938) 4 All ER 337; *Johnson v. Lyttles Iron Agency,* (1877) 5 Ch D 687 (CA). (Time from which interest was demanded).

Except where a forfeiture is wholly void, the articles may provide that in case of any irregularity in the forfeiture, the remedy of the member after the shares are disposed of shall be in damages only. *Bellerby v. Rowland and Marwood's SS Co. Ltd.,* (1902) 2 Ch 14 (CA). *Knight's* case, (1867) 2 Ch App 321; *Re, Home Counties and General Life Assurance Co., Woollaston's* case, (1859) 4 De G & J 437; *Re, State Fire Insurance Co., Webster's* case, (1862) 32 LJ Ch 135; *Kelk's* case, *Pahlen's* case, (1869) LR 9 Eq 107 at 117.

Where shares are once registered in the name of a person, the company has no power to forfeit the shares on the ground of failure of consideration. Its remedy is only to obtain appropriate relief by suit. *Kotah Transport Ltd. v. State of Rajasthan,* (1967) 37 Com Cases 288 : AIR 1966 Raj 136 (DB). Where two directors were allotted qualification shares, without any payment, and these shares were forfeited by a Board resolution passed at the request of those two directors, the forfeiture was held to be invalid and the directors were held liable to pay the nominal value of the shares. *Re, Esparto Trading Co.,* (1879) 12 Ch D 191.

Where the articles permitted forfeiture only for non-payment of calls, it was held that a forfeiture of shares for non-compliance with statutory provisions applicable to trusts, and that too without notice, was outside the permitted range of the power and, therefore, of no validity. The directors should have sought guidance from the CLB before removing the names of the petitioners from the register of members. Their names were accordingly ordered to be restored. *Sulochana Nathany v. Hindustan Malleables & Forgings Ltd.,* (2001) 1 Comp LJ 159 : (2001) 40 CLA 10 : (2001) 29 SCL 22 : (2001) CLC 448 (CLB).

Where partly paid shares, having been forfeited, were reissued without any stipulation that the new allottee was under a liability to pay the outstanding calls, it was held that forfeiture of such shares for non-payment of calls was not in compliance with the requirement of a valid forfeiture. The allottees were unaware of their rights. They should first have been informed and their liability to pay the outstanding amount would be tested according to law. *Satish Chandra Sanwalka v. Tinplate Dealers Assn. P. Ltd.,* (2001) 3 Comp LJ 284 : (2001) 43 CLA 97 : (2001) 32 SCL 338 : (2001) 107 Com Cases 98 (CLB—PB—N. Del).

After shares are forfeited, a further notice is not necessary to complete the forfeiture. *Sha Mulchand & Co. v. Jawahar Mills Ltd.,* (1953) 23 Com Cases 1 : AIR 1953 SC 98. Forfeiture results in the extinction of the rights of the shareholder. It is then not possible for him to transfer the shares though he may question the validity of the forfeiture. Nor is it possible for the transferee to ignore the forfeiture. *Travancore Electro Chemical Industries Ltd. v. Alagappa Textile Cochin Ltd.,* 1972 Tax LR 2192 (Ker–DB).

Notice of forfeiture.—Where notice was sent to the shareholder's registered address in Gibraltar even though the company was informed of the address in UK for service of notices, the notice was held to be good. *Parkstone Ltd. v. Gulf Guarantee Bank Plc.*, 1990 BCLC 250 (Ch D). The object of the notice being to give the shareholder an opportunity for payment of the call money, interest and expenses, it must disclose sufficient information with particulars of the amounts due. A proper notice is a condition precedent to the forfeiture, and even the slightest defect in the notice will invalidate the forfeiture, *Public Passenger Services Ltd. v. M. A. Khader,* (1966) 36 Com Cases 1 (SC).

But the accidental non-receipt of notice of forfeiture by the defaulter is not a ground for relief against forfeiture regularly effected. *Sparks v. Liverpool Water Works Co.,* (1807) 13 Ves 428. Where a shareholder is insolvent, the notice of forfeiture may still be given to him though it would be advisable to inform his receiver or assignee, *Graham v. Van Diemen's Land Co.,* (1856) 26 LJ Ex 73. In the case of a deceased shareholder, as was the case in *Allen v. Gold Reefs of West Africa,* (1900) 1 Ch 656, the notice may be sent to his registered address. In that case the notice in fact reached the executors and LINDLEY MR considered that to be a good notice overriding the doubts expressed in *James v. Buena Ventura Nitrate, etc., Syndicate,* (1896) 1 Ch 456, 465. The power of forfeiture is not lost by the fact that the company has charged its uncalled capital in favour of debenture-holders. *Agency Land and Finance Co. of Australia, Re,* (1903) 20 TLR 41.

Forfeiture for claim other than non-payment of calls.—A power to forfeit shares in order to enforce a lien for debts due from a member otherwise than in respect of calls was held void in *Hopkinson v. Mortimer,* (1917) 1 Ch 646. But this has not been followed in later cases. See *Re, Bolton, Ex parte, North British Artificial Silk Ltd.,* (1930) 2 Ch 48 and also *Shyam Chand v. Calcutta Stock Exchange*, AIR 1949 Cal 337. PALMER'S COMPANY LAW also states that a power to forfeit shares for non-payment of debts other than calls or instalments is invalid as an unauthorised reduction of capital 655 (24th Edn., 1987: Vol. 1, 25th Edn., 1992, para 6.901). Similar opinion is expressed in HALSBURY'S LAWS OF ENGLAND, p. 330 (4th Edn., Reissue, 1988, Vol. 7(1): para 523, p. 384, 4th Edn., Reissue, 1996, Vol. 7(1)).

There may be forfeiture of shares, if the articles provide therefor, for reasons other than those mentioned in Art. 29 of Table A. But the power is in the nature of a trust and must be exercised *bona fide* for the benefit of the company. Where, however, the exercise of the powers is contrary to the policy of law, any forfeiture in the exercise of such power will be invalid. *Hope v. International Financial Society,* (1876) 4 Ch D 327.

Forfeiture of shares does not vest the property in the shares in the company, and it is not an asset of the company and, therefore, there is no reduction of capital because of forfeiture. *Naresh Chandra Sanyal v. Calcutta Stock Exchange Assn. Ltd., (infra); Sri Gopal Jalan & Co. v. Calcutta Stock Exchange Assn. Ltd., (infra).*

Refund of excess realisation on reissue.—The right of the company upon forfeiture is only to dispose of the shares and use the proceeds for discharging the liability for which the forfeiture was effected and if there is any balance it belongs to the defaulter, and cannot be appropriated by the company. *Naresh Chandra Sanyal v. Calcutta Stock Exchange Association Ltd.,* AIR 1971 SC 422 : (1971) 41 Com Cases 51. It was observed that the power to forfeit did not imply any authority to appropriate the balance remaining after satisfying the liabilities and obligations of the defaulter to the company. If a company were permitted to retain any balance after satisfying the debts and liabilities of the defaulting shareholder, such a transaction would not be different from purchasing the share of the defaulting shareholder for value and that would be plainly illegal. This decision was with reference to refund in a case where a *fully paid up share* had been forfeited and was based on the provisions of section 74 of the Contract Act. It is submitted that where the shares are forfeited for non payment of calls, the question of refund of any excess realisation on reissue will not arise.

Forfeiture of fully paid shares.—It has been held that fully paid-up shares also can be forfeited in such cases, as default in fulfilling any engagement between the members, or expulsion of members, where the articles specifically provide therefor. See *Shyamchand v. Calcutta Stock Exchange Association*, AIR 1949 Cal 337. See also *Sri Gopal Jalan & Co. v. Calcutta Stock Exchange Association Ltd.*, AIR 1964 SC 250 and *Naresh Chandra Sanyal v. Calcutta Stock Exchange Assn. Ltd.*, AIR 1971 SC 422 : (1971) 41 Com Cases 51.

Shares which were issued as fully paid were not allowed to be forfeited under an allegation that the shareholder had not paid his call money. Forfeiture was also purported to be carried out at a time when the company's claim to the call money had become time-barred and the shareholder had pledged the shares as fully paid with a financial institution. There was no proof of a call, and even if there could be, a call notice by itself does not permit forfeiture. There has to be a procedure after the default. *Farooq Ahmed (K. Md.) v. Fortran Cirkit Electronics P. Ltd.*, (1998) 92 Com Cases 498 : (1997) 2 Comp LJ 234 at 241 (CLB–SB).

Right to challenge forfeiture.—A person whose shares have been forfeited may maintain a challenge against the forfeiture provided that : (1) the right to challenge the forfeiture is not abandoned; and (2) the plea for rectification of the register of members is made within the period of limitation. In *Sha Mulchand & Co. Ltd. v. Jawahar Mills Ltd.*, (1953) 23 Com Cases 1 : AIR 1953 SC 98, the Supreme Court held that:

(1) in order for a person to be disentitled from challenging a forfeiture of shares, he must have abandoned his right to challenge the forfeiture. Abandonment is something more than mere waiver, acquiescence or laches and is akin to estoppel, if not estoppel itself. The factum of abandonment must be inferred from the acts or conduct of the shareholder.

(2) where the facts on record cannot sustain a plea of waiver, acquiescence or laches, the same facts cannot sustain a plea of abandonment of right.

(3) after shares have been forfeited, a further notice of forfeiture is not necessary.

A forfeiture cannot be challenged on the ground that a notice of sale was not given to the member before sale. The requirement of notice of sale in the case of a pledge under s. 176 of the Contract Act, is not applicable to the case of a forfeiture. *Khadija v. P.K. Mohammed*, (1985) 58 Com Cases 543 at 561 (Ker).

A sale by a company of the shares in exercise of its lien created under the articles of association framed under the Companies Act, 1956, cannot, with justification, be equated to a private sale. A sale by a company, by virtue of the statutory provisions, has many attributes of a court sale. The sale is not done in a secret manner. The affairs of a company could be effectively scrutinised by a shareholder or by successors-in-interest of a deceased shareholder. The details relating to the shareholding can be known by approach to the company or to the statutory authorities. The action of the company is subject to various statutory controls. In that view of the matter, the doctrine of substantial representation and the absence of prejudice applicable to court sales may have application to the sale by a company also [*ibid* at (1985) 58 Com Cases 543 at 562].

Forfeiture in exercise of right of lien.—If the company purported to forfeit the shares of the plaintiff company in enforcement of the lien, such forfeiture would clearly and undoubtedly be illegal and bad. It will be bad and illegal as there is no power in the defendant company to forfeit the shares in enforcement of its lien; and further any forfeiture of the shares in enforcement of the lien will be a clog on the equity of redemption. Forfeiture in enforcement of a lien, whenever it amounts to a clog on the equity of redemption, is bad and illegal and will not be upheld. *Unity Company P. Ltd. v. Diamond Sugar Mills*, AIR 1971 Cal 18 at 36.

Effect of sale of invalidly forfeited shares.—Regulation 34 makes it clear that the transferee is entitled to be registered as shareholder. The only remedy of an aggrieved

former holder of the share is to sue the company for damages and not for recovery of the shares. See *Balwant Gopal v. The Ceramic Industries Ltd., Chanda,* AIR 1951 Nag 266 : (1950) 20 Com Cases 55. Where compensation was not an adequate remedy the court ordered that the name of the aggrieved shareholder be put back in the register of member in respect of the shares which belong to him and the persons to whom the shares were sold may be given some other shares. *Promila Bansal v. Wearwell Cycle Co. (India) Ltd.,* (1978) 48 Com Cases 202, 209, 210 (Del).

Liability after forfeiture.—Where shares are sold for non-payment of calls, the purchaser is liable to a fresh call in respect of the total amount of the prior calls, for the company cannot sell the forfeited shares free from that liability. But, if any amounts are recovered from the ex-holder in respect of the calls, the purchaser will be entitled to the benefit of any amounts so recovered. So also any payments by the purchaser will reduce the liability of the ex-holder. See PALMER'S COMPANY PRECEDENTS, 16th Edn., Part I, page 498 and the cases referred to therein. See *Shiromani Sugar Mills Ltd. v. Debi Prasad,* (1950) 20 Com Cases 296 (All).

Where forfeited shares are re-allotted, while credit will be given for money already received in respect of them, the new allottee will not only be liable for the balance amount remaining on the shares but he will not also be entitled to voting right so long as the calls payable by the original shareholder remain unpaid, if the company's articles so provide, as stated in section 181.

The liability after forfeiture is a new liability arising from the forfeiture and can be enforced within three years from the date of the forfeiture. See *Maneklal v. Suryapar Mills Co. Ltd.,* AIR 1928 Bom 252.

A person whose shares have been forfeited within a year before the commencement of the winding up of the company, is liable as a past member under section 426. *Cryeke's* case, (1869) 5 Ch App 63.

Limitation for recovery of balance after forfeiture.—After forfeiture of his shares, the former holder of the shares becomes a simple debtor and a suit to recover the balance due from him is governed by Article 55 or 113 of the Limitation Act, 1963 time beginning to run from date of forfeiture. For recovery of balance due after forfeiture of shares, limitation for a suit is three years from the date of the forfeiture. Regulation 29 or similar article of a company is a contract (*Cf.* section 36) and gives the starting point. *First National Bank v. Seth Sant Lal,* (1958) 28 Com Cases 402 (Punj); *Bhagwati Prasad v. Shiromani Sugar Mills Ltd.,* (1949) 19 Com Cases 286 (All).

Cancellation of forfeiture.—Where the articles empower directors to annul a forfeiture, the company cannot reinstate the former holder with the liabilities of a shareholder unless he consents. *Larkworthy's* case, (1903) 1 Ch 711. A person whose shares have been forfeited cannot be brought back to his position as shareholder by the directors by rescinding the forfeiture. *Dhunraj Keshrimal v. H.H. Wadia,* (1933) 57 ILR Bom 413. However, an improperly executed forfeiture which is *ultra vires* the power of directors can be revoked by the company. *Bhagirathi Spinning and Weaving Co. v. Balaji,* AIR 1930 Bom 267.

Reallotment of forfeited shares.—A forfeited share may be re-issued in consideration of a lesser sum than the sum credited as paid on it. *Morrison v. Trustees, Executors and Securities Insurance Corporation,* 1898 WN 154. But the power to dispose of shares forfeited for non-payment of share money does not enable the directors to re-allot the forfeited shares as fully paid-up shares at a discount. Such re-allotment will contravene section 79 and will, therefore, be void. *Biochemical & Synthetic Products v. ROC,* (1962) 32 Com Cases 654 : AIR 1962 AP 459.

Forfeited shares may be reallotted, giving credit for money already received in respect of them and only the balance money may be recovered from the reallottee. *New Balkis Eersteling Ltd. v. Randt Gold Mining Co.,* (1904) AC 165 at 168 (HL); The new allottee

is not entitled to vote whilst calls are payable by the original holder of the shares, when the articles provide that no member shall have a vote so long as any calls payable are unpaid: *Randt Gold Mining Co. v. Wainwright,* (1901) 1 Ch 184. Since such a reissue is not an allotment the principles relating to discount issue are not offended. *Morrison v. Trustees, Executors, and Securities Insurance Corpn.,* (1898) 68 LJ Ch 11 (CA); *Re, Exchange Banking Co. Ltd., Ramwell's* case, (1881) 50 LJ Ch 827. Forfeited shares have been treated as 'unissued' on a reduction of capital where sums had already been received in respect of the shares. *Re, Oceana Development Co. Ltd.* (1912) 56 Sol Jo 537; *Re, Victoria (Malaya) Rubber Estates Ltd.,* (1914) 58 Sol Jo 706. Upon reissue, the capital of the company becomes intact. *Calcutta Stock Exchange Assn., Re.,* AIR 1957 Cal 438; *Calcutta Stock Exchange Assn. v. Nandy,* ILR (1950) Cal 235.

Reissue at lower price.—It is open to the Board of directors to reissue the forfeited shares at a lower price. There is no obligation that such shares be allotted at the prevailing market price. Under Article 32 of Schedule I, Table A, the forfeited shares can be sold or otherwise disposed of on such terms and in such manner as the Board thinks fit.

Forfeiture of convertible debentures.—In the case of fully or partly convertible debentures, it is usually stipulated that provisions relating to forfeiture will equally apply to the non-convertible portion. Therefore, if any amount remains unpaid with respect to the convertible and non-convertible portion, the entire debenture can be forfeited. The forfeiture in respect of the non-convertible portion can be carried out in the same manner as in the case of shares.

Jurisdiction for challenging forfeiture.—A company judge held that an application for a declaration that the forfeiture of the shares of a member was illegal was not maintainable. This order was upheld by the Division Bench of the A.P. High Court in *Tej Prakash Dangi v. Coromandal Pharmaceuticals Ltd.,* (2001) 43 CLA 21 : (2002) 108 Com Cases 516 : (2002) 1 Comp LJ 527 (AP—DB). The reason is that jurisdiction for rectification of the register of members of a company is specially vested in the Company Law Board. The Court said that there is no provision in the Act vesting general authority in the High Courts to deal with all matters relating to a company. The Courts are not the only functionaries under the Act to decide all matters. Powers have been vested within the scheme of the Act in other authorities also like the Company Law Board and the Central Government. There is no provision in the Act enabling the High Court to entertain applications relating to forfeiture of shares.

Surrender of shares

A person who hands over his share certificate ceases to be a member of the company in liquidation, for, the share certificates may be surrendered on receiving a return of capital.Therefore, the handing over of the share certificate does not constitute a surrender of shares by a member. A surrender of shares can be made by a member to the company if the company's articles give the directors the power to accept a surrender of shares. Such power is recognised as valid if it is used merely to avoid the formalities of forfeiture, and not otherwise. *Vasant Investment Corpn. Ltd., Re,* (1982) 52 Com Cases 139 (Bom).

A company cannot accept a surrender of its shares "as every surrender of shares, whether fully paid-up or not involves a reduction of capital which is unlawful. . . . Forfeiture is a statutory exception and is the only exception". *Bellerby v. Rowland and Marwood's S.S. Co. Ltd.,* (1902) 2 Ch 14. But a surrender may be dealt with in the manner indicated in *Re, Castiglione's Willtrusts, Hunter v. Mackenzie,* (1958) 1 All ER 480 *viz.*, directing that the shares be held in the name of a nominee as trustee for the company.

A surrender can be accepted in circumstances absolutely parallel to the requirements of a forfeiture, the only difference being that instead of going to the length of the formalities of a forfeiture, the company accepts in good faith in its own interest the shares which the shareholder is voluntarily surrendering. The other advantage to the company is that the shareholder becomes estopped from questioning the validity. It is not open to a shareholder to surrender the shares held by him, or to the company to accept the surrender un-

less the matter can be brought within the rules relating to forfeiture. Where the reduction of share capital caused by surrender which is not authorised by the articles is void, the person who surrendered the shares cannot take advantage of any acceptance of such surrender. *Collector of Moradabad v. Equity Insurance Co. Ltd.*, AIR 1948 Oudh 197 : (1948) 18 Com Cases 309; *Mangalsen v. Indian Merchants Bank, Amritsar*, AIR 1928 Lah 240; *Mirza Ahmed Nawazi, Re*, AIR 1924 Mad 703.

§ See also Notes under section 100 under the heading "Surrender of shares to company".

Mortgage or pledge of shares

Shares and debentures are movable property and like any other movable property can be subjected to a mortgage or pledge for securing a loan. The security can be created either by way of a legal or an equitable mortgage.

Legal Mortgage.—Legal mortgage takes place when on the registers and records of the company the mortgagee (the lender) is made the legal owner of the shares. This transfer is as between the mortgagor and mortgagee effective only for the purpose of securing the repayment of the loan. The company's register of members will not carry a notice of the mortgage because a company cannot be required to take notice of a trust affecting the shares. The borrower has a right to pay back the lender and to ask him to retransfer the securities in the name of the borrower. During the period that the lender remains the registered shareholder the company will pay to him all dividends and other monies with respect to the shares and he is entitled to vote.

A registered transfer of shares, even if by way of security in favour of the lender, would be a clear cut complete transfer. No residuary interest in the pledged shares would survive in favour of the shareholder. His interest is protected by the right of redemption, namely, his right to have the shares retransferred on paying back the amount due under the transaction. *M. Ratnavarma Padival v. Karnataka Theatres Ltd.*, (2000) CLC 489 : (2000) 38 CLA 171 (Kant).

A legal mortgagee may vote as he wishes in respect of the mortgaged shares, and is not bound to obey the directions of the mortgagor, for he is not a trustee of the voting rights for him until the mortgagor has paid off the debt secured by the mortgage. *Siemens Bros. & Co. Ltd v. Burns*, (1918) 2 Ch 324.

It is however usual to stipulate in the agreement that the dividends will be paid to the borrower and that the lender will exercise the voting rights to the shares in accordance with the wishes of the borrower. A legal mortgage on shares provides the best security which the lender can obtain. He being already registered shareholder he is certain that his security cannot be defeated by any fraud on the part of the borrower. But this method has three disadvantages also: It involves the payment of stamp duties twice over, *viz.*, on transfer and retransfer and it is not a suitable security when shares are not fully paid-up because the liability to pay the calls will fall directly on the mortgagee and it is also inappropriate in the case of shares held by a director because he cannot part with his qualification shares.

Equitable Mortgage.—An equitable mortgage of shares is normally created by the deposit of the share certificates relating to the shares. *Fuller v. Glyn Mills, Currie & Co.*, (1914) 2 KB 168; *Harrold v. Plenty*, (1901) 2 Ch 314. This may be done either way or without delivery of a blank transfer to the lender. The borrower remains on the register of members and retains all the rights of a member unless there is some arrangement on the point between himself and the lender. It is a matter of common practice in connection with equitable mortgages of shares that the borrower is required to sign the blank transfer forms and to hand them over to the lender along with sharescrips with this intention that the lender will fill up the blank form and perfect the security by getting himself registered if the borrower makes a default in paying back the lender. *Kanhaiyalal Janwar v. Pandit Shirali & Co.*, (1953) 23 Com Cases 399 : AIR 1953 Cal 526; *Hibblewhite v. McMorine*,

(1840) 6 M & W 200; *Powell v. London and Provincial Bank,* (1893) 2 Ch 555; *France v. Clark,* (1884) 26 Ch D 257; *Re, Tahiti Cotton Co.* (1874) LR 17 Eq 273; *Re, Tees Bottle Co.,* (1876) 33 LT 834.

§ See also Notes under S. 111 under the heading "Transfer in respect of pledged shares", for the validity and effectiveness of such transactions.

Usually the mortgagor executes a document which sets out the terms of the mortgage transaction, in particular, the date on which the loan secured on the shares is to be repaid, the rate of interest on the loan and the powers of the mortgagee to realise his security if the mortgagor defaults. If the loan is not repaid on the agreed date, the mortgagee may sell the shares or apply to the court for a foreclosure order. *Harrold v. Plenty,* (1901) 2 Ch 314; *Deverges v. Sandeman, Clark & Co.,* (1902) 1 Ch 579.

He may also in the alternative sell the shares after giving reasonable notice or can exercise the usual rights of a mortgagee to foreclose, *Stubbs v. Slater,* (1910) 1 Ch 632; *Harrold v. Plenty,* (1901) 2 Ch 314. See also *Deverges v. Sandeman, Clarke & Co.,* (1902) 1 Ch 579, where the sale of shares by the mortgagee was held to be good and *Arjun Prasad v. Central Bank of India,* AIR 1956 Pat 32 where the bank got itself registered as a member in the winding up of the company with court order and *Kunhunni & Elaya Nayar v. Krishna Pattar,* AIR 1943 Mad 74 where mortgage by deposit of share certificates was recognised as a valid security. See further *Belton v. Bass, Ratcliff & Gretton,* (1922) 2 Ch 449, where the mortgagee himself purchased the shares. Where a shareholder executes blank transfers to enable another to deal with the shares, he is bound not to do anything to prevent registration of the transfer; and if he improperly intervenes, he is liable in damages. The measure of damages in such a case is the difference between the value of the shares (*i.e.* the price which could have been realised on a sale of the shares) at the time when the transfer ought to have been registered and the value at the time when the transfer was in fact registered. *Hooper v. Herts,* (1906) 1 Ch 549.

Where a wife handed over certain shares owned by her to her husband for safe custody and the husband pledged them with a bank as security for overdraft, it was held that the husband was a mere bailee and not an agent and even though the share certificates had attached to them a transfer form signed in blank by the wife, the husband had no authority to pledge them and the bank obtained no valid claim over the shares. *Benaras Bank Ltd. v. Prem and Co.,* (1937) 7 Com Cases 116 at 199 (All).

If the mortgagee sells the shares to another person he gets only the rights of the mortgagee, *e.g.*, to hold the shares as a security for the value of the mortgage money. He cannot get better rights because the transfer form is in blank and this puts him on notice. *France v. Clarke,* (1884) 26 Ch D 257. When exercising his power of sale, whether conferred on him expressly by the terms of the mortgage or implied by law, the mortgagee must use reasonable care to obtain the best price possible, and he is liable in damages to the mortgagor if he fails to do so. The mortgagor may recover from the mortgagee personally, or set off against his personal liability for the secured debt, any deficiency in the price which the mortgagee obtains to satisfy the amount owing under the mortgage and the mortgagee's costs of realisation. This can be done only to the extent that the price which the mortgagee could have obtained if he had exercised reasonable care exceeds the price which he actually obtained. *Cuckmere Brick Co. Ltd. v. Mutual Finance Ltd.,* (1971) 2 All ER 633; *Bishop v. Bonham,* (1988) BCLC 656 (CA). This is so even if the mortgage provides that the mortgagee shall not be liable for any loss, however arising, in connection with the sale of the shares by him. A shareholder who gives his agent a blank transfer of shares with authority to borrow will be bound by a pledge of those shares by the agent even if it was not in accordance with the direction of the shareholder. *Fry v. Smellie,* (1912) 3 KB 282.

This form of mortgage of shares is not at all a good security for, if the transferor fraudulently tells the company that he has lost his certificate, he can get a new one and transfer the same shares to a purchaser. It is no use to give an ordinary notice of the

mortgage to the company, as the company is not bound to take notice of any trusts or equities affecting the shares. The only safe course is to give the company a stop notice supported by an affidavit. The effect is that if the mortgagor attempts to transfer the shares, the company will not do so without giving notice to the mortgagee.

Another kind of weakness of this kind of security has been exposed by the decision in *Malleswara Finance and Investment Co. P. Ltd. v. CLB,* (1994) 81 Com Cases 66 : AIR 1994 Mad 341. The allotment and issue of the shares which were under a pledge were set aside by the Company Law Board. Consequently the pledge became a nullity. It made no difference that the pledges's name was put on the register of members and he was exercising the normal rights of a shareholder. Setting aside of the allotment caused automatic rectification of the register of members affecting all the interests which might have been created on those shares. The pledgee was holding only derived rights which could not be greater than those of his pledger and, therefore, he could not claim that he should have been heard before his name was deleted from the register of members. The pledge did not have the effect of transfer particularly because under the articles of the company shares had to be offered first to the existing members and on their refusal, to any outsider whom directors would approve. Even otherwise when an original allotment is set aside all transfers automatically fall to the ground. **Affirmed** by the Division Bench in *Malleswara Finance and Investments Co. P. Ltd. v. CLB,* (1995) 82 Com Cases 836 (Mad—DB); *Shoe Specialities P. Ltd. v. Stridewell Leathers P. Ltd.,* (1995) 82 Com Cases 836 (Mad—DB).

Certain shares were held nominally in the name of a company for the benefit of another company. The nominee company pledged the shares in favour of a person who advanced money in good faith and without notice. The action of the beneficial owners of the shares against the pledgee for conversion of their property was dismissed. The company had no immediate legal right to the shares nor the shares were in its possession. Before such a claim was possible actual possession, or a right to immediate possession, would be required. The court also added that where a court had already ruled on title to a disputed asset, the parties would not be allowed to relitigate the issue. *MCC Proceeds Inc. v. Lehman Brothers International (Europe),* (1998) 2 BCLC 659 (CA). The **contrary** principles are stated in *International Factors Ltd. v. Rodriguez,* (1979) 1 All ER 17.

Priority between transferees

As between persons taking blank transfers one after the other their priorities will depend upon the date on which the blank transfer form was handed over and not the date when the purported transferee sent the transfers to the company for registration. *Societe Generale de Paris v. Walker,* (1885) 11 App Cas 20. If none of the transfers are registered, the first in point of time has priority. *Peat v. Clayton,* (1906) 1 Ch 659. Thus where a husband holding his wife's share in trust for her mortgaged them without authority and the wife asserted her claim before the mortgage was registered it was held that she had a prior right to the shares. *Ireland v. Hart,* (1902) 1 Ch 522. Similarly where a subsequent transferee gets his name registered with notice of the prior transfer, he is not entitled to any priority. *Coleman v. London County & Westminster Bank,* (1916) 2 Ch 353. This priority is not lost merely because there is some detail which remains to be done by the company before he is put on the register. *Moore v. North Western Bank,* (1891) 2 Ch 599. This detail must be something that the company is bound to do. Where there are two competing claimants for title to shares registered in the name of a third person, the title prior in date prevails. The claimant second in point of time has to show, in order to establish his priority, that he has, before the receipt by the company of the notice of the prior title, acquired the full status of a shareholder or that all formalities have been complied with and nothing more than ministerial act remains to be done by the company which, as between himself and the company. The company is bound to do forthwith. *Sethna (R.P.) v. National Bank of India,* (1911) 13 Bom LR 998 (OCJ) (Bom).

Mortgagees altering their priority.—Where the shares in question were mortgaged to two mortgagees, it was held that the mortgagees could agree as between themselves to alter their priority without the consent of the mortgagor because in the ordinary case the mortgagor is not affected by the order in which his debts are paid as he is bound to satisfy all his secured debts before he can recover the property. The court observed *per curiam* that where a mortgagor has a genuine interest in ensuring that his debts are satisfied in a particular order, *e.g.* where there are different rates of interest, he should insist on a specific contractual provision precluding the alteration of the priorities. *Cheah v. Equiticorp Finance Group Ltd.*, 1992 BCLC 371 PC (on appeal from New Zealand).

Transfer by guardian on behalf of minor

The fact that some of the shares under transfer were sold by the guardian on behalf of the minor and there was no court order about the utilisation of the sale proceeds was regarded by the CLB as something about which the guardian has to take care and not the company. Over these points and some other alleged irregularities, CLB appointed, with the consent of the parties, a practising company secretary, to inquire into the matter and ordered that the decision would go according to his findings. *Hemangini Finance & Leasing P. Ltd./Essar Investments Ltd. v. Tamilnad Mercantile Bank Ltd.*, (1996) 86 Com Cases 875 (CLB—Mad).

Partition of Hindu undivided family

Where shares standing in the name of 'A' are to be transferred to the name of 'B' pursuant to a partition of the assets a Hindu Undivided Family of which they were members, the partition may not constitute a transfer, it is nevertheless the act of the coparceners dividing the joint-family property among themselves and allotting specific assets to individual members of the family. The individual coparcener derives his title from the partition, which is an act of parties. It is presumed that a duly stamped transfer form must be lodged with the company to enable it to give effect to the partition.

Execution of transfer by manager (Karta) of family.—Investment in shares which represents the property of a joint Hindu family is held in the name of a member of a family. Section 108 enables the execution of a transfer deed by or on behalf of the transferor or the transferee. In the case of a joint family, the transfer form would be executed by the holding member or, in his absence, by the manager (*Karta*) of the family who represents the family. *Vickers Systems International Ltd. v. Mahesh P. Keshwani*, (1992) 73 Com Cases 317 (CLB). The same would be true when the family is a transferee. The CLB directed the company to register shares in the name of the Hindu undivided family showing Mahesh P. Keshwani as its *Karta*. See also *Piari Lal v. Muir Mills Co.*, AIR 1919 All 619 and the Notes under heading 'Transmission of Shares' *ante*, where other cases are also discussed on the related subject.

Family arrangement is not a transfer.—Shares which have been allocated between parties *inter se* pursuant to a family settlement or a family arrangement can be registered in the Register of Members without insisting on a transfer deed. A family arrangement does not amount to a transfer. The essential features of a family arrangement and their legal aspects have been discussed by the Supreme Court in *Aryamurthi (M.N.) v. M.L. Subbaraya*, AIR 1972 SC 1279.

Section does not apply to involuntary transfers

'Transfer' in the section means a transfer by sale or otherwise by the registered holder of shares. It cannot have any application to involuntary or forced sales such as a Court auction-sale or sale of forfeited shares for non payment of calls *etc.* See *Mohideen Pichai Taraganar v. Tinnevilly Mills Co. Ltd.*, AIR 1928 Mad 571; *Mahadeo Lal v. New Darjeeling Union Tea Co. Ltd.*, AIR 1952 Cal 58; *Unity Company (P.) Ltd. v. Diamond Sugar Mills*, (1970) 2 Comp LJ 64 at 106 (Cal).

Joint shareholders

In the case of joint shareholders, where they want splitting of the shares and registering them in their individual names, they must follow the procedure prescribed for transfer of shares in this section, and the applications should be stamped with the prescribed stamp duty in respect of the shares, as converting a joint holding into separate holding is essentially a transfer from joint ownership into individual ownership. *Hemlata Saha v. Stadmed (Private) Ltd.,* (1964) 34 Com Cases 875 : AIR 1965 Cal 436. The decision in *Hemlata Saha* was **followed** in *Rajiv Das (Dr.) v. United Press Ltd.,* (2001) 44 CLA 268 : (2002) 1 Comp LJ 170 : (2002) 111 Com Cases 584 (CLB—ER). It was a refusal by the company to split shares held jointly. The consent of other joint holders was not taken. The original certificates, or transfer deeds, duly signed and stamped, as required under the Act, were also not furnished. The refusal by the company was held to be justified. It was neither illegal, nor without sufficient cause.

In *Burns v. Siemens Brothers Dynamo Works Limited,* (1919) 1 Ch 225, two persons, Burns and Hambro, were the registered joint holders of a large number of shares in the company. Under the articles Burns alone as the first named holder was entitled to vote, and the second named holder Hambro could neither vote, nor could be appointed proxy for a poll, so that if Burns was ill or absent the voting power was lost. It was held that in order to enable Burns and Hambro effectually to exercise their voting power in all circumstances, they were entitled to have their holding split into two joint holdings with their names in different orders, and it was ordered that the register be altered accordingly. In this case, the observations of WARRINGTON J. in *In re, Saunders & Co. Limited,* (1908) 1 Ch 415 at 423, were cited with **approval.** The learned judge said: "It seems to me that the joint holders of shares are entitled to arrange among themselves which of them shall stand first on the register of members and exercise on behalf of all the right of voting which belongs to them collectively."

Where under the articles of a company the shares were transferable from one shareholder only to other shareholders, it was held that the transfer of shares by one joint shareholder to his joint shareholders was a transfer to a shareholder of the company and not to an outsider. This is so because every joint shareholder is also a member within the meaning of S. 30(2) of Companies Act, 1913 [C.A., 1956, S. 41] *Jarnail Singh v. Bakshi Singh,* (1960) 30 Com Cases 192 : AIR 1960 Punjab 455. The court cited an example of a case in which two joint shareholders were treated as two separate members for the purposes of quorum at a meeting. *Transcontinental Hotel Ltd., Re,* (1947) SASR 49 (Aust).

A transfer of shares held jointly by more than one person is not valid unless all the shareholders sign the transfer form. *Shanta Genevier Pommeret v. Sakal Papers P. Ltd.,* (1990) 69 Com Cases 65 (Bom). Where the names of two executors were jointly entered on the register of members in respect of the testator's shares, one of the co-executors purported to sell the shares by forging the signature of the other on a transfer deed, it was held that whatever the powers of executors might be with regard to other property vested in them in that character, one executor alone could not have transferred shares registered in the names of both. See *Barton v. North Staffordshire Railway Co.,* (1888) 38 Ch D 458; *Barton v. London & North Western Railway Co.,* (1889) 24 QBD 77 and *Barton v. The Scinde, Punjaub and Delhi Railway Co.,* (1889) 5 TLR 644.

Department's views.—The Department is of the view that there is no need of transfer deeds for transposition of names *i.e.* change in order of names of joint shareholders provided such request is made by all shareholders jointly to the company. However, where the change in order of names is required in respect of a part of the holdings, execution of a transfer deed will be required (*Letter No.* F1/24/SE/80, dated 5-9-1980). It is submitted that in the case of joint holders they can insist on having their names registered in such order as they may require in respect of any parts of their holdings and this should require no transfer deed as the ownership continues to remain in the joint holders name and only the order of names is transposed or changed.

Death of joint holder

Where shares are held in joint names, and one of the joint holder dies the survivor alone will be recognised as the holder of the said shares. It would be sufficient for the company to delete the name of the deceased shareholder after obtaining satisfactory evidence of his death. This of course does not prevent a third person from calling on the company to register his name as holder of the shares after obtaining evidence such as probate of a will for the purpose of proving his title to the shares as against the surviving joint holders.

In the case of death of a joint shareholder, unless the articles otherwise provide, the rule of English law is that the survivor or survivors of the joint holders are alone entitled to and liable upon such shares, even where the surviving joint holder is a corporate body. See *Maria Anna and Steinbank Coal and Coke Co., Re, Maxwell's* case, (1875) LR 20 Eq 585; *Re, Thompsons Settlement Trust, Re, Thompson v. Alexander,* (1905) 1 Ch 229. But in India there is no reason why the principle of section 45 of the Indian Contract Act should not apply, so that the representatives of the deceased joint holder would be entitled jointly with the survivor or survivors.

Accordingly, there is no reason why where there is no dispute as regards the person or persons entitled as heirs of a deceased joint shareholder, the heirs should not be registered as members jointly with the surviving joint shareholders, even if the latter does not agree to such joint registration. Of course in case of dispute *inter se* among the heirs, the matter will have to be decided by the civil court, and the company will be guided by the decision.

The Company Law Board has held in *Mrs. Kamala V. Pai v. Messrs Esso Standard Refining Company of India Ltd.* (*Hindustan Petroleum Corporation Ltd.*) (Appeal No. 1 of 1977 order dated 23-2-1977), (1997) 3 Comp LJ 138 that where the heirs of a deceased joint shareholder had obtained a succession certificate and the surviving joint shareholder had disclaimed interest in the shares, the company ought not to refuse registration of the shares in the names of the heirs of the deceased joint shareholder.

But in the case of companies which have adopted an Article on the lines of Regulation 25 (1) of Table A of Schedule I which provides that on the death of a joint shareholder, the survivor or survivors shall be the only persons who will be recognised by the company as having any title to the interest of the deceased in the shares, the Article will be binding on the joint shareholders as a contract between them and the company (*Vide* section 36). If so, how can any succession certificate or other order of a court vary the contractual force of the Article? The rights as between the joint shareholders *inter se* and/or their heirs will have to be worked out as between themselves, and the company cannot be compelled to register any of the heirs of a deceased joint shareholder jointly with the survivor.

The Special Court (Trial of Offences Relating to Transactions in Securities) Act, 1992

This Act has been enacted to provide for establishment of Special Court for trial of offences arising out of the securities scam of 1992.

§ For the full text of the Act and the cases decided under it see *Appendix* 292.

Where special permissions are necessary for Special Court for trial of securities.— Where the transfer in question could be effected only with the permission of Special Court (Trial of Offences Relating to Transactions in Securities) Ordinance, 1992, it was held that the refusal by the company to accept the transfer without such permission was justified. *Castrol India Ltd. v. S.S. Mehta,* (1993) 78 Com Cases 146 (CLB).

§ See also Notes under this section under the heading "Special Court for trial of Securities Scam", *post.*

Negotiated Deals and Cross Deals

§ For Notes on this subject see Notes under section 73 *ante*.

§ For earstwhile FEMA, 1999 provisions see *Appendix* 101.

Transfer of shares not to contravene the erstwhile Foreign Exchange Regulation Act, 1973

Transfer in relation to any security as defined by section 2(w) of FERA, 1973 included transfer by way of loan or security. This definitions will therefore include transfer by way of pledge or mortgage.

Before any transfer of shares by or in favour of non-residents is considered, it is necessary to see whether it contravenes any provision of the Foreign Exchange Regulation Act, 1973. In particular, it must be noted that no transfer of shares can be made or registered in favour of a person not resident in India, unless Reserve Bank permission has been obtained. (See section 19(1) and (4), Foreign Exchange Regulation Act, 1973).

Also no transfer by a non-resident to a resident or non-resident can be valid, unless the transfer is confirmed by the Reserve Bank or exempted by the Central Government [*vide* sub-section (5) *ibid*].

In *Life Insurance Corporation of India v. Escorts Ltd.*, (1986) 59 Com Cases 548 : AIR 1986 SC 1370, the Supreme Court held, **reversing** the decision of the Bombay High Court that the expression used in S. 29(1) is "general or special permission of the Reserve Bank of India" and that the expression is not qualified by the words 'previous' or 'prior'. The court held that while it is true that the words 'previous' or 'prior' may be implied, that could not be done in the instant case since the expression 'permission' was qualified by these words in some sections of the FERA but not in others, so that the Parliament must be deemed to have deliberately avoided qualifying the word 'permission' in S. 29(1). The court also rejected a submission that the permission must be deemed to be prior, since penal consequences would follow under S. 50 if the shares were purchased before applying for permission and permission was refused. In our opinion, the judgment of the High Court in *Escorts Ltd. v. Union of India*, (1985) 57 Com Cases 241 (Bom) is correct.

Decisions under section 26 of FERA by virtue of FERA Amendment Act of 1993 are only of historic interest. For the meaning of the words transfer of interests in any business as used in that section, see *Venkataswamy R. Naidu v. Director Enforcement*, (1993) 78 Com Cases 87 (Mad).

Transfer of securities under FEMA, 1999

Under section 2 (ze) of FEMA, 1999, 'transfer' includes sale, purchase, exchange, mortgage, pledge, gift, loan or any other form of transfer of right, title, possession or lien. Section 6(3) of FEMA 1999 empowers RBI to prohibit, restrict or regulate, *inter alia*, the following matters:

transfer or issue of any foreign security by a person resident in India [*Clause (a)*];

transfer or issue of any security by a person resident outside India [*Clause (b)*];

transfer or issue of any security or foreign security by any branch, office or agency in India of a person resident outside India [*Clause (c)*];

Pursuant to the provisions of section 6(3), RBI has issue the following Regulations:

(1) FEM (Transfer or Issue of Any Foreign Security) Regulations, 2000 [For text, see *Appendix* 116]

(2) FEM (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000 [For text, see *Appendix* 118].

(3) FEM (Issue of Security in India by a Branch, Officer or Agency of a Person Resident outside India) Regulations, 2000. [For text, see *Appendix* 106].

§ See Notes under sec. 591.

(1) Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2000

"Foreign security" means any security, in the form of shares, stocks, bonds, debentures or any other instrument denominated or expressed in foreign currency and includes securities expressed in foreign currency, but where redemption or any form of return such as interest or dividends is payable in Indian currency. [*Clause 2(o) of FEMA, 1999*].

Reg. 3 prohibits issue or transfer of any foreign security except in accordance with the provisions of FEMA, 1999 and rules/regulations made under that Act.

These regulations seek to regulate acquisition and transfer of a foreign security by a person resident in India *i.e.* investment by Indian entities in overseas joint ventures and wholly owned subsidiaries as also investment by a person resident in India in shares and securities issued outside India.

(2) (i) In terms of Regulation No. 4, general permission has been granted to residents for purchase/acquisition of securities—

(a) out of funds held in RFC account;

(b) issued as bonus shares on existing holding of foreign currency shares; and

(c) sale of shares/securities so acquired.

(ii) General permission has also been granted to a person resident in India for purchase of securities out of their foreign currency resources outside India as also for sale of securities so acquired.

(3) For the purpose of investment in foreign securities in other cases the Regulations have been divided in two parts *viz.* –

Part I	-	Direct Investment outside India (in Joint Ventures and wholly- owned subsidiaries abroad) [See Notes under section 372A].
Part II	-	Investment in Foreign securities other than by way of Direct investment

[*See Annexure II to AD (MA Series) Circular No. 11 dt. 16-5-2000*]

(2) Transfer of shares and convertible debentures under FEM (Transfer or Issue of Securities by a Person Resident outside India) Regulations, 2000

The FEM (Transfer or Issue of Security by a Person Resident Outside India) Regulations 2000 framed under FEMA, 1999 provides, *inter alia,* for the following matters:

Transfer of any security by a person resident outside India, which does not fall under the general permission category, requires RBI's permission. [*Reg. 3*].

Similarly, a company cannot record in its books any transfer of security *from or to* a person resident outside India unless such transfer is either under the general permission as provided in the Regulations, or with RBI's permission. [*Reg. 4*].

AP (DIR Series) Circular No. 38, dt. 3-12-2003.—In this Circular, RBI has given a gist of the current regulatory provisions relating to foreign investment. Paras 4.1 and 4.2 relating to transfer of security read as follows:—

General permission [*Para 4.1*]

General permission has been granted to non-residents/NRIs for transfer of shares and convertible debentures of an Indian company as under:—

- A person resident outside India (other than NRI and OCB) may transfer by way of sale or gift the shares or convertible debentures to any person resi-

dent outside India (including NRIs/OCBs) provided transferee has obtained prior permission of Central Government to acquire the shares if he has previous venture or tie-up in India through investment in shares or convertible debentures or a technical collaboration or a trade mark agreement or investment in the same field or allied field in which the Indian company whose shares are being transferred, is engaged.

- NRIs or OCB may transfer by way of sale or gift the shares or convertible debentures held by him or it to another non-resident Indian.
- The person resident outside India may transfer any security to a person resident in India by way of gift.

Prior permission of RBI in certain cases for transfer of security [*Para 4.2*]

A person resident in India who proposes to transfer any share or convertible debenture of an Indian company by way of sale or gift to a person resident outside India will have to obtain prior approval of Secretariat for Industrial Assistance, Govt. of India, followed by permission from the RBI. The above two-stage approval is applicable even when the transfer is made on non-repatriation basis. A person resident outside India holding shares/convertible debentures of an Indian company may transfer by way of sale to a person resident in India by obtaining prior permission from RBI in form TS 1.

Transfers under general permission

Transfer of shares and convertible debentures or other securities by persons outside India.—Reg. 9 of the Regulations grants general permission for transfer of shares and convertible debentures of an Indian company by a person resident outside India subject to certain conditions.

A person resident outside India holding the shares or debentures of an Indian company in accordance with these Regulations, may transfer the shares or debentures so held by him, in compliance with the conditions specified in the relevant Schedule of these Regulations. [*Reg. 9(1)*].

Transfer by a person resident outside India, other than NRI/OCB, to a person resident outside India.—A person resident outside India, not being a non-resident Indian or an overseas corporate body, may transfer by way of sale or gift the shares or convertible debentures held by him or it to any person resident outside India. [*Reg. 9(2)(i)*].

Transfer by NRI/OCB to NRI/OCB.—A non-resident Indian may transfer by way of sale or gift, the shares or convertible debentures held by him or it to another non-resident Indian or overseas corporate body only. [*Reg. 9(2)(ii)*].

Provided that the person to whom the shares are being transferred, in terms of clauses (i) and (ii), has obtained prior permission of Central Government to acquire the shares if he has previous venture or tie up in India through investment in shares or debentures or a technical collaboration or a trade mark agreement or investment by whatever name called in the same field or allied field in which the Indian company whose shares are being transferred is engaged:

Provided further that the restriction in clauses (i) and (ii) shall not apply to the transfer of shares to international financial institutions such as Asian Development Bank (ADB), International Finance Corporation (IFC), Common-wealth Development Corporation (CDC), Deutsche Entwicklungs Gescelscchaft (DEG) and transfer of shares of an Indian company engaged in Information Technology sector.

Transfer by person resident outside India by gift or sale.—A person resident outside India holding the shares or convertible debentures of an Indian company in accordance with these Regulations,—

(a) may transfer the same to a person resident in India by way of gift;

(b) may sell the same on a recognised Stock Exchange in India through a registered broker. [*Reg. 9(2)(iii)*] [*Subs. by GSR No. 558(E), dt. 18-6-2003*].

A person resident outside India including OCBs shall not transfer by way of sale or gift, the shares or convertible debentures held by them to another OCB. [*AP (DIR Series), Circular No. 14, dt. 16-9-2003*].

Transfers requiring Prior permission of RBI

Under Reg. 10, prior permission of Reserve Bank is necessary in the following cases for transfer of security

Transfer by way of gift by a person resident in India to a person outside India.—A person resident in India who proposes to transfer to a person resident outside India any security, by way of gift, shall make an application to the Reserve Bank furnishing the following information, namely:

(i) Name and address of the transferor and the proposed transferee

(ii) Relationship between the transferor and the proposed transferee

(iii) Reasons for making the gift. [*Reg. 10.A(a)*].

Transfer by way of sale by a person resident in India to a person outside India.—A person resident in India who proposes to tranfer to a person resident outside India, any share/convertible debenture of an Indian company, by way of sale, shall obtain the Government approval for the transfer and thereafter apply to the Reserve Bank for its approval, which may be granted subject to such conditions as are considered necessary by Reserve Bank, including the price at which such sale may be made. [*Reg. 10A(b)*].

Transfer by way of sale not covered by Regulation 9 by a person resident outside India to a person resident in India [Reg. 10B]

Application.—Transfer by way of sale not covered by Regulation 9 (General permission cases) by a person resident outside India of the shares/convertible debentures held by him to a person resident in India, shall require prior permission of the Reserve Bank, for which application in *Form TS 1* may be made to the Reserve Bank. [*Reg. 10.B. (1)*].

Consideration of application by RBI.—While considering the grant of permission, the Reserve Bank shall take into account the following factors.

(a) **Listed Company.**—Where the shares of an Indian company are traded on stock exchange,

(i) the sale is at the prevailing market price on stock exchange and is effected through a merchant banker registered with Securities and Exchange Board of India or through a stock broker registered with the stock exchange;

(ii) if the transfer is other than that referred to in clause (i), the Reserve Bank will satisfy itself that the shares are proposed to be sold at a price arrived at by taking the average quotations (average of daily high and low) for one week preceding the date of application with 5 percent variation. Where, however, the shares are being sold by the foreign collaborator or the foreign promoter of the Indian company to the existing promoters in India with the objective of passing management control in favour of the resident promoters the proposal for sale will be considered at a price which may be higher by upto a ceiling of 25 percent over the price arrived at as above, [*Reg. 10.B.(2)(a)*].

(b) **Unlisted or thinly traded company.**—Where the shares of an Indian company are not listed on stock exchange or are thinly traded,

(i) if the consideration payable for the transfer does not exceed Rs.20 lakh per seller per company, at a price mutually agreed to between the seller and the buyer, based on any valuation methodology currently in vogue, on submission of a certificate from the statutory auditors of the Indian company whose shares are proposed to be transferred, regarding the valuation of the shares, and

(ii) if the amount of consideration payable for the transfer exceeds Rs.20 lakh per seller per company, at a price arrived at, at the seller's option, in any of the following manner, namely:

(A) a price based on earning per share (EPS linked to the Price Earning (P/E) multiple, or a price based on the Net Asset Value (NAV) linked to book value multiple, whichever is higher,

or

(B) the prevailing market price in small lots as may be laid down by the Reserve Bank so that the entire shareholding is sold in not less than five trading days through screen based trading system

(C) where the shares are not listed on any stock exchange, at a price which is lower of the two independent valuations of share, one by statutory auditors of the company and the other by a Chartered Accountant or by a Merchant Banker in Category 1 registered with Securities and Exchange Board of India. [*Reg. 10.B(2)(b)*].

Explanation:

(i) **Meaning of 'thinly traded share'.**—A share is considered as thinly traded if the annualised trading turnover in that share, on main stock exchanges in India, during the six calendar months preceding the month in which application is made, is less than 2 percent (by number of shares) of the listed stock.

(ii) **Computation of Net Asset Value.**—For the purpose of arriving at Net Asset Value per share, the miscellaneous expenses carried forward, accumulated losses, total outside liabilities, revaluation reserves and capital reserves (except subsidy received in cash) shall be reduced from value of the total assets and the net figure so arrived at shall be divided by the number of equity shares issued and paid up. Alternatively, intangible assets shall be reduced form the equity capital and reserves (excluding revaluation reserves) and the figure so arrived at shall be divided by the number of equity shares issued and paid up. The NAV so calculated shall be used in conjunction with the average BV multiple of Bombay Stock Exchange National Index during the calendar month immediately preceding the month in which application is made and BV multiple shall be discounted by 40 per cent.

(iii) **Computation of Earning Per Share.**—For computing the price based on Earning Per Share, the earning per share as per the latest balance sheet of the company shall be used in conjunction with the average Price Earning Multiple of Bombay Stock Exchange National Index for the calendar month preceding the month in which application is made and Price Earning shall be discounted by 40 per cent.

Remittance of sale proceeds

(1) No remittance of sale proceeds of an Indian security held by a person resident outside India shall be made otherwise than in accordance with these Regulations and the conditions specified in the relevant Schedule.

(2) An authorised dealer may allow the remittance of sale proceeds of a security (net of applicable taxes) to the seller of shares resident outside India

Provided -

(a) the security was held by the seller on repatriation basis;

(b) either the security has been sold on a recognised stock exchange in India through a stock broker at the ruling market price as determined on the floor of the exchange, or the Reserve Bank's approval has been obtained in other cases for sale of the security and remittance of the sale proceeds thereof; and

(c) a no objection/tax clearance certificate from the Income Tax authority has been produced. [*Reg. 11*].

FEM (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000 regulate, *inter alia,* the purchase and sale of shares or convertible debentures of an Indian company under the Portfolio Investment Scheme—

(A) by a Foreign Financial Investor;

(B) by a Non-resident Indian.

(A) Purchase/sale of shares/convertible debentures by FIIs under Portfolio Investment Scheme [*Reg. 5 and Sch. 2*]

A registered Foreign Institutional Investor (FII) may purchase shares or convertible debentures of an Indian company under the Portfolio Investment Scheme, subject to the terms and conditions specified in *Schedule* 2. FII may, through the Securities and Exchange Board of India, apply to the Reserve Bank for permission to purchase the shares and convertible debentures of an Indian company under Portfolio Investment Scheme. The permission may be granted by Reserve Bank subject to such terms and conditions as may be considered necessary. FII shall not, however, purchase shares or convertible debentures of an Indian company which is engaged in the print media sector.

SEBI (Foreign Institutional Investors) Regulations, 1995

SEBI has issued these regulations under *Notification* SO 918(E), dated 14-11-1995. For the text of these Regulations see *Appendix* 193.

PURCHASE/SALE OF SHARES AND/OR CONVERTIBLE DEBENTURES OF AN INDIAN COMPANY BY A REGISTERED FOREIGN INSTITUTIONAL INVESTOR UNDER PORTFOLIO INVESTMENT SCHEME [SCHEDULE 2]

1. Purchase/sale of shares and/or convertible debentures

(1) A registered Foreign Institutional Investor (FII) may, through the Securities and Exchange Board of India, apply to the Reserve Bank for permission to purchase the shares and convertible debentures of an Indian company under Portfolio Investment Scheme. The permission may be granted by Reserve Bank subject to such terms and conditions as may be considered necessary.

(2) The registered FII permitted by the Reserve Bank under sub-paragraph 1, shall purchase the shares/convertible debentures of an Indian company through registered brokers on recognised stock exchanges in India.

(3) The amount of consideration for purchase of shares / debentures shall be paid out of inward remittance from abroad through normal banking channels or out of funds held in an account maintained with the designated branch of an authorised dealer in India, in accordance with these Regulations.

(4) The total holding by each FII/SEBI approved sub-account of FII shall not exceed 10% (ten per cent) of the total paid-up equity capital or 10% (ten per cent) of the paid-up value of each series of convertible debentures issued by an Indian company and the total holdings of all FIIs/sub-accounts of FIIs put together shall not exceed 24 per cent of paid-up equity capital or paid up value of each series of convertible debentures.

[*Provided* that the limit of 24 per cent referred to in this paragraph may be increased upto the sectoral cap/statutory ceiling, as applicable, by the Indian company concerned by passing a resolution by its board of directors followed by passing of a special resolution to that effect by its genreal body.] *Subs. by Notification No. FEMA 45/2001-RB, dt. 20-9-2001.*

Explanation:

For arriving at the ceiling on holdings of FIIs, shares/ convertible debentures acquired both through primary as well as secondary market will be included. However, the ceiling will not include investment made by FII through off-shore Funds, Global Depository receipts and Euro-Convertible Bonds.

[(5) A registered FII is permitted to purchase shares/convertible debentures of an Indian company through offer/private placement, subject to the ceiling specified in sub-paragraph (4) of this paragraph and the Indian company is permitted to issue such shares :

Provided that—

(i) in case of public offer, the price of the shares to be issued is not less than the price at which shares are issued to residents, and

(ii) in case of issue by private placement, the price is not less than the price arrived in terms of SEBI guidelines or guidelines issued by erstwhile Controller of Capital Issues, as applicable] [*Subs. by GSR No. 558(E), dt. 18-6-2003*].

2. Maintenance of account by a registered FII for routing transactions of purchase and sale of shares/convertible debentures

The Reserve Bank may, on application, permit a registered Foreign Institutional Investor to open a Foreign Currency Account and/or a Non-resident Rupee Account with a designated branch of an authorised dealer for routing the receipt of and payment for transactions relating to purchase and sale of shares / convertible debentures under this Scheme, subject to the following conditions :

(i) The account shall be funded by inward remittance through normal banking channels or by credit of sale proceeds (net of taxes) of the shares/convertible debentures sold on stock exchange.

(ii) The funds in the account shall be utilised for purchase of shares/convertible debentures in accordance with the provisions of paragraph 1 of this Scheme or for remittance outside India.

(iii) The funds from Foreign Currency Account of the registered FII may be transferred to Non-Resident Rupee account of the same FII and *vice versa*.

3. Remittance of sale proceeds of shares/convertible debentures

The designated branch of an authorised dealer may allow remittance of net sale proceeds (after payment of taxes) or credit the net amount of sale proceeds of shares/convertible debentures to the foreign currency account or a Non-resident Rupee Account of the registered Foreign Institutional Investor concerned.

4. Investment by Asset Management Company/Portfolio Manager

(1) Reserve Bank may, subject to such terms and conditions as it may consider necessary permit a domestic asset management company or portfolio manager who is registered with SEBI as a foreign institutional investor for managing the funds of a sub-account, to make investment under the Scheme on behalf of:

(i) a person resident outside India who is a citizen of a foreign state ,or

(ii) a body corporate registered outside India ,

Provided such investment is made out of funds raised or collected or brought from outside India through normal banking channel,

(2) The application to Reserve Bank for permission under sub-paragraph (1) may be made through SEBI.

(3) Investments permitted to be made under sub-paragraph (1) shall not exceed 5% (five per cent) of the total paid-up equity capital or 5% (five per cent) of the paid-up value of each series of convertible debentures issued by an Indian company, and shall also not exceed the over-all ceiling specified in sub-paragraph (4) of paragraph 1 of this Schedule.

B. Purchase/sale of shares/convertible debentures by NRI on non-repatriation basis

A non-resident Indian (NRI) may purchase shares or convertible debentures of an Indian company on a Stock Exchange under Portfolio Investment Scheme, subject to the terms and conditions specified in Schedule 3, provided that the NRI shall not purchase shares or convertible debentures of an Indian company which is engaged in print media sector. [*Reg. 5(3)*].

Purchase/Sale of Shares and/or Convertible Debentures by an NRI on a Stock Exchange in India on Repatriation and/or Non-Repatriation basis under Portfolio Investment Scheme [Schedule 3]

1. A Non-resident Indian (NRI) may purchase/sell shares and/or convertible debentures of an Indian company, through a registered broker on a recognised stock exchange, subject to the following conditions :

[(i) NRI may purchase and sell shares/convertible debentures under the Portfolio Investment Scheme through a branch designated by an authorised dealer for the purpose and duly approved by the Reserve Bank of India] [*Subs. by GSR No.558(E), dt. 18-6-2003*]

(ii) the paid-up value of shares of an Indian company, purchased by each NRI both on repatriation and on non-repatriation basis, does not exceed 5 percent of the paid-up value of shares issued by the company concerned;

(iii) the paid-up value of each series of convertible debentures purchased by each NRI both on repatriation and non-repatriation basis does not exceed 5 percent of the paid-up value of each series of convertible debentures issued by the company concerned;

(iv) the aggregate paid-up value of shares of any company purchased by all NRIs does not exceed 10 percent of the paid up capital of the company and in the case of purchase of convertible debentures the aggregate paid-up value of each series of debentures purchased by all NRIs does not exceed 10 percent of the paid-up value of each series of convertible debentures;

Provided that the aggregate ceiling of 10 per cent referred to in this clause may be raised to 24 per cent if a special resolution to that effect is passed by the General Body of the Indian company concerned;

(v) the NRI investor takes delivery of the shares purchased and gives delivery of shares sold;

(vi) payment for purchase of shares and/or debentures is made by inward remittance in foreign exchange through normal banking channels or out of funds held in NRE/FCNR account maintained in India if the shares are purchased on repatriation basis and by inward remittance or out of funds held in NRE/FCNR/NRO/NRNR/NRSR account of the NRI/OCB concerned maintained in India where the shares/ debentures are purchased on non-repatriation basis;

(vii) @[* * * *]

2. Report to Reserve Banl:

[The link office of the designated branch of an authorised dealer referred to in paragraph 1, shall furnish to the Chief General Manager, RBI, ECD, Central Office, Mumbai, a report on daily basis on PIS transactions undertaken by it, such report to be furnished on line or on floppy or in hard copy in a format supplied by the Reserve Bank."] *Subs. by Notification No. FEMA/46/2001-RB, dt. 29-11-2001.*

3. Remittance/credit of sale/maturity proceeds of shares and/or debentures

The net sale/maturity proceeds (after payment of taxes) of shares and/or debentures of an Indian company purchased by NRI or OCB under this Scheme, may be allowed by the designated branch of an authorised dealer referred to in paragraph 1,—

(a) to be credited to NRO account of the NRI/OCB investor where the payment for purchase of shares and/or debentures sold was made out of funds held in NRO account or where the shares and/or debentures were purchased on non-repatriation basis, or

(b) at the NRI or OCB investor's option, to be remitted abroad or credited to his/its NRE/FCNR/NRO/NRO account of the NRI, where shares and/or debentures were purchased on repatriation basis. [*Subs. by GSR No. 558(E), dt. 18-6-2003*].

(3) FEM (Issue of Security in India by a Branch Office or Agency of a Person Resident outside India) Regulations, 2000

§ See Notes under sections 591-594.

Safe Custody of Shares/Securities

Authorised dealers and financial institutions extending custodial services may hold in their safe custody, shares and securities issued/transferred to non-residents and also release the shares/securities from non-resident safe custody account for purposes like recording change of name, sale, *etc.*, provided the relative purchase/sale/transfer is covered by the general or special permission of Reserve Bank.] [*RBI Exchange Control Manual, 1993, para 10A.6*

Investment in Sick Industrial Units

§ For Notes see under section 72 *ante.*

Investment in securities other than shares or convertible debentures

(i) Government dated secuirities

@ The words "the Overseas Corporate Body (OCB) informs the designated branch of the authorised dealer immediately on the holding/interest of NRIs in the OCB becoming less than 60 per cent." omitted, *ibid.*

(ii) treasury bills
(iii) domestic mutual funds
(iv) PSU bonds
(v) PSU shares on disinvestment
(vi) money market mutual funds
(vii) National plan/savings certificates.

The relevant subject matter has been dealt with under FEM (Transfer or Issue of Securities by a Person Resident outside India) Regulations, 2000. [*See Reg. 5(4) read with Sch. 5*].

Registration of Shares and Investment by NRIs/OCBs in Joint Names

(i) Shares/debentures purchased by NRIs/OCBs should be held and registered in the names of either the investor himself or an authorised dealer or the latter's nominee/s.

(ii) Shares/debentures can be purchased by NRIs in joint names with other NRIs with permission of Reserve Bank. In such cases, if the investment is with repatriation benefits, the first holder is to be treated as investor for the purpose of 5% ceiling. The second or third holder will be eligible to invest separately in the same company in his own name as the first holder in joint holdings up to the limit of 5%. Reserve Bank will also permit investment jointly with residents. However, if the resident joint holder inherits the shares/debentures, he/she will not be entitled to repatriation benefits. [*RBI Exchange Control Manual, 1993, para 10C.22*]

Conversion of Holdings of Securities into Joint Holdings between residents/Non-Residents

By its Notification No. FERA.145/93-RB, dated 26th April, 1993 issued under sub-sections (1) and (5) of Section 19 of FERA 1973, Reserve Bank has granted general permission to NRIs/resident Indian citizens for conversion of their holdings in securities issued or registered in India, into joint holdings by addition of the names of persons of Indian nationality or origin subject to the following conditions:

(a) An NRI to convert his holding into joint holding by addition of name/s of person/s of Indian nationality/origin resident in India provided (i) transfer formalities as required under the Companies Act, 1956 are complied with and (ii) dividend income or sale proceeds of the securities accruing to the person resident in India are not repatriated outside India in the event of his becoming a non-resident sole (or joint named) holder of the security by succession, gift or otherwise.

(b) A resident Indian citizen to convert his holding into a joint holding by addition of name/s of an NRI/s provided (i) the resident holder continues to be the first holder; (ii) the joint holding is treated as non-resident holding in the books of the company; (iii) any dividend or income or sale proceeds becoming payable to NRIs are credited to his NRO account and (iv) the securities are not sold or disposed of otherwise than through a member of a recognised stock exchange in India, except with the permission of Reserve Bank.

*[**Note :** See paragraph 10C.24A regarding repatriation of income/interest earned during the financial year 1994-95 and onwards] [*RBI Exchange Control Manual, 1993, para 10C.31*]

Permission for sale/transfer of nominal number of shares from subscribers to the memorandum and articles of association of 100 per cent owned subsidiaries to parent company or their nominees

Foreign companies which apply to FIPB for setting up 100 per cent owned subsidiary, very often, pending receipt of FIPB approval, request some resident individuals to complete the formalities of registering an Indian company by subscribing to the memorandum and articles of association and acquiring nominal number of shares (usually less than 500). After

obtaining the FIPB approval, the foreign owners seek to acquire the nominal number of shares from the subscribers to the memorandum and articles of association. Presently, application for permitting such transfers are required to be made to the RBI. The RBI *vide* its notification No. FERA 207/99-RB, dated 31st July, 1999 (*see* Annex-II), has granted general permission to a person resident outside India or a company incorporated outside India to acquire shares from the shareholders who had acquired such shares as signatories to the memorandum and articles of association provided (*i*) the Indian company is permitted to become a 100 per cent owned subsidiary; (*ii*) the total number of shares so acquired does not exceed 500; and (*iii*) the face value of the shares to be transferred is less than 0.1 per cent (one tenth of one per cent) of the paid-up capital of the Indian company. The company whose shares are so released and/or a depository have also been granted permission to enter an address outside India in their books in respect of such shares.

ANNEX II

NOTIFICATION NO. FERA 207/99-RB DATED 31ST JULY, 1999

Permission for sale/transfer of shares from subscribers of the memorandum and articles of association of 100 per cent owned subsidiaries of foreign firms/companies, *etc.*, to parent foreign companies or their nominees

In pursuance of the powers conferred by clause (*b*) of sub-section (1) of section 29 and the clause (*b*) of sub-section (4) of section 19 of the Foreign Exchange Regulation Act, 1973 (46 of 1973), the Reserve Bank of India hereby permits—

(*a*) a person resident outside India or a company incorporated outside India to acquire shares from the shareholders who had acquired such shares as signatories to memorandum and articles of association:

Provided—

(*i*) the Indian company whose shares are so acquired is permitted to become a 100 per cent owned subsidiary of the foreign firm/company or is allowed to be entirely held by persons resident outside India (*i.e.*, either Government approval for acquisition of 100 per cent shares has been granted or there exists a general permission to have foreign investment upto 100 per cent under the automatic route);

(*ii*) the total number of shares so acquired does not exceed 500 and the face value of shares to be transferred is less than 0.1 per cent (one tenth of one per cent) of the paid-up capital of company;

(*b*) the company whose shares are so released and/or a depository defined in clause (2) of sub-section (1) of section 2 of the Depositories Act, 1996 to enter in its register or books in which securities are registered or inscribed, as address outside India of the non-resident holder of shares.

§ For FEMA, 1999 Provisions, refer *Appendix* 101, see also Notes under sec. 372-A for provisions of FEMA, 1999.

For further details refer H.P. AGARWAL, BUSINESS COLLABORATIONS IN INDIA, 6th Edn., 2001 and B.J. CHACKO, NRI, TAXATION, INVESTMENTS AND INCENTIVES, 10th Edn., 1994-95.

Registrars to an Issue and Share Transfer Agents

The companies generally engage agents popularly known as Registrars for Share Transfers and Issue of Certificates. For the regulation of the business of such Agents, Rules and Regulations have been promulgated and have been printed in respective Appendices as follows:

1. Securities and Exchange Board of India (Registrars to an Issue and Share Transfer Agents) Rules, 1993 [*Appendix* 209].
2. Securities and Exchange Board of India (Registrars to an Issue and Share Transfer Agents) Regulations, 1993 [*Appendix* 210].
3. SEBI Operational Guidelines/Instructions to Registrars to an Issue (RTI) and Share Transfer Agents (STA)—*vide* SEBI Circular, dated 11-10-1994 [*Appendix* 212].
4. Report of the Chandrashekhran Committee on Share Transfer Procedure [*Appendix* 213].

List of prescribed authorities for the purposes of endorsement of date [Sub-s. (1-A)(a)]

1. S.O. No. 2776, dated 19-9-1966

1. All the Registrars of Companies.
2. The Company Prosecutor (Grade II), Office of the Regional Director, Company Law Board, Bombay.
3. The Accounts Officer, Office of the Regional Director, Company Law Board, Bombay.
4. The Superintendent (Grade II), Office of the Regional Director, Company Law Board, Bombay.
5. The Senior Technical Assistants, Office of the Registrar of Companies, Bombay.
6. The Superintendent (Grade I), Office of the Registrar of Companies, Bombay.
7. The Company Prosecutor (Grade III), Office of the Registrar of Companies, Bombay.
8. The Junior Technical Assistants, Office of the Registrar of Companies, Bombay.
9. The Senior Technical Assistants, Office of the Registrar of Companies, Ahmedabad.
10. The Superintendent, Office of the Registrar of Companies, Ahmedabad.
11. The Company Prosecutor (Grade III), Office of the Registrar of Companies, Ahmedabad.
12. The Junior Technical Assistants, Office of the Registrar of Companies, Ahmedabad.

2. S.O. No. 3271, dated 27-10-1966

13. The Superintendent, Office of the Registrar of Companies, Bangalore.
14. The Superintendent, Office of the Registrar of Companies, Madras.

3. S.O. No. 3681, dated 3-12-1966

15. The Senior Technical Assistants, Office of the Registrar of Companies, Jaipur.

4. S.O. No. 1060, dated 14-3-1967

16. The Superintendent, Office of the Registrar of Companies, Andhra Pradesh, Hyderabad.

5. S.O. No. 2035, dated 30-5-1967

17. The Senior Technical Assistants, Office of the Registrar of Companies, Punjab, Haryana, Chandigarh and Jullundur.

6. S.O. No. 3264, dated 5-9-1967

18. The Superintendent, Office of the Registrar of Companies, Madhya Pradesh, Gwalior.

7. S.O. No. 364, dated 8-1-1968

21. The Official Liquidator, High Court, Allahabad.

8. S.O. No. 3591, dated 27-9-1971

19. Assistant Commissioner of Income-tax Circle II (1), Indore.

9. S.O. No. 1960, dated 3-8-1989

20. The Senior Technical Assistants, Office of the Registrar of Companies, Kanpur.

10. S.O. No. 725(E), dated 29-9-1992

21. Additional Registrar of Companies, Delhi *Jurisdiction*—Delhi and Haryana.
22. Assistnat Registrar of Companies, Delhi, *Jurisdiction*—Delhi and Haryana.
23. Junior Technical Assistant, Office of the Registrar of Companies, Goa, *Jurisdiction*—Goa.

11. S.O. No. 164(E), dated 14-2-1994

24. The Official Liquidator, High Court, Indore.

I. Following is the list of prescribed authorities, besides the Registrars of Companies, for the purposes of Clause (a) of sub-section (1-A) appointed by Central Government *vide Notification No.* SO 279(E), dated 10-4-1992 superseding the earlier *Notification No.* 214(E), dated 28-3-1984.

Notification No. SO 279(E), dated 10-4-1992.—In exercise of the powers conferred by sub-rule (1) of rule 5A of the Companies (Central Government's) General Rules and Forms, 1956, and in supersession of the Notification SO No. 214(E), dated 28-3-1984 except as respects things done or omitted to be done before such supersession, the Central Government hereby appoints the following authorities as prescribed authorities for the purposes of clause (a) of sub-section (1A) of section 108 of the Companies Act, 1956 (1 of 1956), namely:

1. Assistant Commissioner of Income Tax, Company Circle-I, (1), Pune
2. Income Tax Officer, (Technical & P.R.), Nagpur
3. Income Tax Officer, C.I.B., Lucknow
4. Income Tax Officer, Circle III, Ward-B, Surat

5. Income Tax Officer, Company Circle III, Coimbatore
6. Income Tax Officer, Headquarters, Madurai
7. Income Tax Officer, 'A' Ward, Varanasi
8. Income Tax Officer, Agra
9. Income Tax Officer, SIC-I, Jabalpur
10. Income Tax Officer, 'A' Ward, Dhanbad
11. Income Tax Officer, IIB Circle, Baroda
12. Income Tax Officer, 'E' Ward, Bhopal
13. Income Tax Officer, 'A' Ward, Jamshedpur
14. Income Tax Officer, 'C' Ward, Ulhashnagar, Thane
15. Income Tax Officer, City Circle I, Trichinapalli
16. Income Tax Officer, Distt. 1 (5), Ludhiana
17. Income Tax Officer, 'A' Ward, Vishakhapatnam
18. Income Tax Officer, Distt, IV, Amritsar
19. Income Tax Officer, 'A' Ward, Circle II, Calicut
20. Assistant Commissioner of Income Tax, Circle-1, Vijayawada
21. Income Tax Officer, Circle (I), Meerut
22. Income Tax Officer-IInd, Hubli (Hubli-Dharwad)
23. Income Tax Officer, 'C' Ward, Trivandrum
24. Income Tax Officer, Company Circle I, Salem
25. Income Tax Officer, 'A' Ward, Sholapur
26. Income Tax Officer, 1st Assessment, Ranchi

†[27. Deputy Commissioner of Income Tax, Circle-II(1), Indore]

28. Deputy Regional Director of National Savings Organisation, Mangalore

II. By *Notification No.* S.O. 786(E), dated 8-11-1982 [(1983) 53 Com Cases (St) 52] the Central Government has appointed "Consular Officer in the Indian Missions Embassies abroad" as prescribed authority for purposes of s. 108(1A) clause (a).

Transfer of shares by Public Financial Institutions

The Supreme Court has laid down that when a public financial institution transfers a bulk of its shareholdings, it should keep in mind not only business expediency but also the impact that the bulk transfer is likely to create on public interest. *N. Parthasarthy v. CCI,* (1991) 72 Com Cases 651 (SC). This is their duty under Article 39(b)(c) of the Constitution of India, 1950.

Disinvestment by Public Undertakings

The Government transferred 51% holding in BALCO in pursuance of a policy decision. The decision was challenged in a public interest litigation. The Supreme Court rejected the petition. The Court was of the view that the Government policy could not be challenged unless it could be shown that it was of *mala fide* origin or was illegal. The valuation of shares was considered to be a question of fact and not of law. The scheme envisaged transfer of management alongwith employees. The Court said that the employees were not entitled to be heard either during the decision making or implementation of the process of disinvestment. They could not say that the protection of Articles 14 and 16 should continue, even when they cease to be employees of a Government undertaking. It being a public interest litigation, the Court emphasised the need for early disposal. An *ex parte* stay order was not to be granted and that, even if it were to be granted, the same should be done on appropriate terms, such as indemnity. *Balco Employees Union v. Union of India,* (2002) 108 Com Cases 193 (SC).

Courts do not interfere in the processes of disinvestments by public sector undertakings unless the implementation of disinvestment policy is of arbitrary nature. Disinvestment up to forty-nine per cent, leaving the company still as a public sector undertaking does not call for any judicial interference. The sale by the Government of its shares may be by public announcement or by inviting tenders. Either way it is a valid method. Prior consultation with the management of the company or its employees is not necessary. Employees do not have the right to say that 26% of the shareholding should be offered to them. The price at which the shares were offered to the employees was found by the court to be not arbitrary. The court directed the Government to device a scheme for effective worker participation in its disinvestment. *Babu Mathew (Prof.) v. U.O.I.,* (1997) 90 Com Cases 455 : (1998) 1 Comp LJ 72 (Kar—DB).

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† Subs. for 'Assistant Commissioner of Income Tax, Circular II(1), Indore' by Notification No. SO 619(E) dt. 24-7-2000.

Over the need for bringing about worker participation, the court suggested the following approach: "Experiments in developed and developing countries have established that participation of workers in the capital of the employer-company by holding shares, will not only improve productivity and loyalty to the industry, but also develop a sense of belonging, resulting in improved employer-employee relationship. When the Directive Principles contemplate workers participating in the management, and the industrial policy contemplates participation of the workers in the capital, there should be a wholehearted effort to make available a substantial portion of shares to the workers on attractive terms while making disinvestment. Employees do not purchase shares as a mere investment, but on account of a sense of involvement and as a form of security. Obviously, they cannot be equated to members of the general public or institutions purchasing shares as a business proposition or for profit. It is not sufficient to provide for a token allotment to the employees, if they are willing to purchase more shares. To give effect to the policy of disinvestment, there is an immediate need to formulate a scheme for effective workers' participation in the capital also. Such a scheme should, among other relevant matters, provide for (a) the extent of participation by the workers in the capital of the company; (b) the nature of concessions that should be extended to the workers to enable them to acquire shares by giving a reasonable discount in the share price and by granting reasonable time or instalments for payment of the share price; and (c) safeguards to ensure that such shares are retained by the workers, either by stipulating that the shares are non-transferable except to other BEL employees or by prohibiting transfer during a specified period". [(1997) 90 Com Cases 455 at 483 (Ker—DB)]. "**Applied** in *Gurnam Singh Gujral (Col.) v. Indian Hotels Co. Ltd.*, (2002) 112 Com Cas 86 : (2002) 40 SCL 321 (CLB).

Substantial acquisition on disinvestment by Listed Public Sector Undertaking

SEBI (Substantial Acqusition of Shares and Takeover) Regulations, 1997.—Provisions have been made in these Regulations relating to substantial acquisition of shares or voting rights or control on disinvestment by a *listed* public sector undertaking.

The relevant regulations deal with the following matters:

(*a*) Public announcement by acquirer [*Reg. 11(3)*].

(*b*) Timing of public announcement offer [*Reg. 14(1)*]

(*c*) Minimum offer price [*Reg. 20(4) to 20(b)*]

(*d*) General obligations of the acquirer [*Reg. 22(7) and (16) and Reg. 23(8)*]

(*e*) Competitive bid [*Reg. 25(2A)*].

§ For text of the "SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 refer *Appendix* 177.

§ See also Notes under section 395 *et seq.*

Utilisation of ECB Proceeds.—ECB proceeds (*i.e.* proceeds of ADRs/GDRs/FCCBs/ECBs) could be used in the first stage of acquisition of shares in the disinvestment process and also in the mandatory second stage offer to the public. [*Press Release, dt. 3-7-2002 (F. No. 4(22)/2002-ECB) issued by Ministry of Finance*].

Acquisition of shares on disinvestment in the Overseas Market

The Operative Guidelines for disinvestment of shares by the Indian companies in the overseas market through issue of ADRs/GDRs have been notified by the Government of India, Ministry of Finance *vide* Notification No. 15/23/99-NRI dated 29th July, 2002.

§ For text of the Operative Guidelines, see *Appendix* 120(37).

Foreign Currency Coverible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993

An Indian company may sponsor an issue of ADRs/GDRs with an overseas depository against shares held by its shareholders at a price to be determined by the Lead Manager.

In respect of—

(a) divestment by shareholders of their holdings of Indian companies listed in India,

(b) divestment by shareholders of their holdings of Indian companies not listed in India but which are listed overseas. [*Para 3(1)(i)*].

This facility is subject to compliance with provisions of the Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 and guidelines issued by the Central Government from time to time. [*See Paras 3(1)(ii) to (iv)*].

§ For text of the FCCB Scheme, 1993, see *Appendix* 119.

Special court for trial of securities and scam cases

A special court was constituted under the Special Court (Trial of Offences Relating to Transactions in Securities) Act, 1992 for taking care of complaints arising out of the securities scam. The complaint in this case was that the accused had dishonestly misappropriated the sale proceeds of securities which were handed over to him for sale. The Act covers the transactions between the relevant period of April 1, 1991 and up to June 6, 1992 and applies to persons known as "notified persons" within the meaning of the Act. It was held that the court had jurisdiction to entertain the complaint and try the offence of criminal breach of trust. *Minoo Mehta v. Shavak D Mehta,* (1998) 2 Comp LJ 217 : (1998) 16 SCL 188 (SC).

The provisions of the Act have been held to be Constitutionally valid. *Harshad Shantilal Mehta v. Custodian,* (1998) 3 Comp LJ 193 (SC). It was held in the same case that the tax liability of the notified persons arising in the period covered by the Act (1-4-1991—6-6-1992) has to be cleared before payment to banks and financial institutions. The Special Court cannot sit in appeal over the orders of Tax Authorities. The Special Court may, however, decide how much of liability as finally assessed may be discharged out of funds available with the Custodian and also may apply Wednesbury Principle of Proportionally scaling down the claim where it is grossly disproportionate to properties available with the Custodian.

Where the securities of a notified person were under the pledge of a bank, it was held that the Custodian was not entitled to the custody of such securities unless they were first redeemed. Similarly, new shares in respect of such securities under rights or bonus scheme, or dividends or interests on such securites, also belong to the pledgee and were not to be handed over to the Custodian till redemption. The pledgee bank was also entitled to dispose of the securities for realisation of its claims. *Standard Chartered Bank v. Custodian,* (2000) 37 CLA 378 (SC); *Hiten P. Dalal v. Standard Chartered Bank,* (2000) 37 CLA 378 (SC).

Employees Stock Option Scheme issued by Ministry of Industry

Press Note, dated 16-12-1997.—The text of the Press Note is reproduced in *Appendix* 279. [See (1998) 91 Com Cases (St) p.1].

List of Financial Institutions approved under section 108(1C)

(1) Any banking company (other than a scheduled bank) as defined in section 5(c) of the Banking Regulation Act, 1949 (10 of 1949).

(2) Any co-operative bank as defined in section 2(b)(ii) of the Reserve Bank of India Act, 1934 (2 of 1934).

(3) The Industrial Development Bank of India (set up under the Industrial Development Bank of India Act, 1934).

[*Source : GSR. 900, dt. 4-6-1966*]

(4) The Industrial Finance Corporation—set up under the Industrial Finance Corporation Act, 1948.

(5) All State Financial Corporations (set up under the State Financial Corporation Act, 1951).

(6) The Industrial Credit and Investment Corporation of India Limited, Bombay.

(7) The Madras Industrial Investment Corporation Ltd., Madras.

(8) The International Finance Corporation, Washington (USA).
(9) Life Insurance Corporation of India.
(10) The New India Assurance Company Ltd., Bombay.
(11) The Oriental Fire and General Insurance Company Ltd., Bombay.
(12) The India Guarantee and General Insurance Company Ltd., Bombay.
(13) The Hercules Insurance Company Ltd.

(14) Advance Insurance Company Ltd., Bombay. [*Source : GSR. 1499, dt. 24-9-1966*]

(15) Co-operative Assurance Company Ltd. [*Source : GSR. 1918, dt. 12-12-1966*]
(16) Great Pyramid Insurance Company Limited, Calcutta.
(17) Sundaram Finance Ltd., Madras.
(18) National Insurance Company Ltd., Calcutta.
(19) Calcutta Insurance Limited, Calcutta.

(20) British India General Insurance Company Ltd. [*Source : GSR. 609, dt. 14-4-1967*]

(21) Madras Motor and General Insurance Company Ltd. [*Source : GSR. 1444, dt. 4-9-1967*]

(22) New Great Insurance Company of India Ltd. [*Source : GSR. 789, dt. 19-4-1968*]

(23) Jupiter General Insurance Company Ltd. [*Source : GSR. 2182, dt. 19-8-1969*]

(24) Hindustan Ideal Insurance Co. Ltd. [*Source : GSR. 2762, dt. 9-12-1969*]

(25) Unit Trust of India, established under the Unit Trust of India Act, 1963. [*Source : GSR. 299, dt. 21-2-1970*]

(26) Risk Capital and Technology Finance Corporation Limited. [*Source : SO 297, dt. 15-1-1979*]

(27) The Housing Development Finance Corporation. [*Source : GSR. No. 114(E), dt. 22-2-1989*]

(28) Tourism Finance Corporation of India Limited. [*Source : SO 2033, dt. 7-8-1980*]

(29) Small Industries Development Bank of India (Established under the Small Industries Development Bank of India Act, 1989). [*Source : GSR. 938(E), dt. 22-12-1992*]

Delay in transfer of shares, issue of allotment letters, and refund etc

Press Note, dated 11-1-1991.—The Department has issued detailed instructions on this subject, *vide* Press Note No. 17/8/89—CL-V, dated 11-1-1991. The text of the Press Note is reproduced under s. 111 under the above noted heading.

Delay in Transfer of Shares by Companies—Clarification

SEBI Circular, dt. 27-9-2001.—In the meeting of stock exchanges held on August 14, 2001, the matter relating to 'Delay in transfer of shares by the Companies' was deliberated and the following decisions were taken for speedy redressal of grievances pertaining to (a) Pending transfer of Shares, (b) Dealing with objection memos in future and (c) Duplicate share certificates.

(A) Pending Transfer of Shares

(i) In case the transfer deed and the share certificates are with the company awaiting transfer beyond 30 days and in cases where the same are returned by the company to the investor with a company objection including due to signature difference (other than court cases where injunction has been ordered), companies shall effect the transfer of shares on obtaining from the transferee the proof of purchases duly acknowledged by the stock exchange/broker. If so desired, a company may also obtain indemnity bond from the transferee. Before effecting transfer, the company shall within 10 days of the date of such direction, send letters under registered post AD/Speed Post AD to the transferor(s) asking for their confirma-

tions/no-objection, so as reach the company within 15 days from the date of receipt of the letter by the transferor. If the confirmation is received/no-objection is not received within 15 days from the transferor(s), the transfer would be effected immediately thereafter. The valid objection, if any should be accompanied by correspondingly old prohibitory order from a competent authority. Immediately after effecting the transfer of shares, the benefits (*i.e.,* Bonus, rights, dividend) held back by the company shall be handed over to the transferee. If such benefits have been passed on to the transferor, the concerned stock exchange shall arbitrate through the brokers of the transferor and the transferee to determine the rightful claimant. Keeping in view the provisions of Section 206A of the Companies Act and Section 27 of the Securities Contracts (Regulation) Act, 1956, in such cases, the Stock Exchanges should entertain claims for resolving through arbitration even if they are beyond the stipulated time of 4 months.

(ii) In respect of complaints (other than court cases where injunction has been ordered) where the original transfer deeds have been lost in the process of rectification on account of company objection, companies shall transfer the shares as per the first proviso to sub-section (1) of Section 108 of the Companies Act on obtaining from the transferee the proof of purchases duly acknowledged by the Stock Exchange/broker on an indemnity bound from the transferee. Before effecting transfer, the company shall within 10 days of the date of such direction, send letters under registered post AD/Speed post AD to the transferor(s) asking for their confirmations/no-objection, so as reach the company within 15 days from the date of receipt of the letter by the transferor. If the confirmation is received/no objection is not received within 15 days, the transfer would be effected immediately thereafter. The valid objection, if any, by the transferor shall be accompanied by correspondingly old prohibitory order from a competent authority. Immediately after effecting the transfer of shares, the benefits (*i.e.,* Bonus, rights, dividend) held back by the company shall be handed over to the transferee. If such benefits have been passed on to the transferor, the concerned stock exchange shall arbitrate through the brokers of the transferor and the transfer to determine the rightful claimant. Keeping in view the provisions of the Section 206A of the Companies Act and Section 27 of the Securities Contracts (Regulation) Act, 1956, in such cases, the Stock Exchanges should entertain claims, even if they are beyond the stipulated time.

(iii) In respect of companies where shares and transfer deeds are lying with the investor or introducing broker-member (IM), and IM has already paid/replaced shares to buyer/broker due to bad delivery on account of objection memo raised by the company, but there was a delay on the part of the company in raising objection beyond the stipulated time period of one month, shares shall be transferred by the company to the investor/IM, as applicable, provided no objection certificate of the buyer/buying broker is provided.

(B) Procedure for dealing with Company objections in future

(i) In respect of complaints where shares and transfer deeds are lying with the investor of introducing the broker-member (IM) and IM has already paid/replaced shares to buyer/broker due to bad delivery on account of objection memo raised by the company, but there was a delay on the part of the company in raising objection beyond the stipulated time period of 1 month. In such cases the company would be liable to compensate the aggrieved party for the opportunity losses during the intervening period.

(ii) In cases of company objection due to signature difference (Other than court cases where injunction is ordered), companies shall effect the transfer of shares by following the procedure mentioned below. Before effecting transfer, the company shall within 10 days of receipt of shares from the transferee, send letters under registered post AD/Speed Post AD to the transferor(s) asking for their confirmation/no-objection, so as to reach the company within 15 days from the date of receipt of the letter by the transferor. If the confirmation is received/no objection is not received within 15 days, the transfer would be effected immediately thereafter. The valid objection, if any, should be followed/accompanied by a prohibitory order from a competent authority and should reach the company within 30 days thereafter, failing which the transfer would be effected. Immediately, after effecting the transfer of shares, the benefits (i.e., Bonus, rights, dividend) held back by the company shall be handed over to the transferee. If such benefits have been passed on to the transferor, the stock exchange shall arbitrate through the brokers of the transferor and the transferee to determine the rightful claimant. Keeping in view the provisions of Section 206A of the Companies Act and Section 27 of the Securities Contracts (Regulation) Act, 1956. In such cases, the Stock Exchanges are hereby advised to entertain claims even if they are beyond the stipulated time.

(iii) In cases where transfer deed and the share certificates are with the company and the company has not effected transfer of shares, within the stipulated time period of one month, without communicating the investor any valid objection. In such cases the company would be liable to compensate the opportunity losses occurred to the investor (buyer). In addition, the company shall transfer the shares immediately and keeping in view the provisions of Section 206A of the Companies Act and Section 27 of the Securities Contracts (Regulation) Act, 1956, provide all benefits (*i.e.,* bonus shares, dividend) which accrued to the investor during the intervening period on account of such delay.

(iv) Once a share certificate is returned by a transfer agent as a "company objection" keeping in view the provisions of Section 206A of the Companies Act and Section 27 of the Securities Contracts (Regu-

lation) Act, 1956, all benefits must be held in abeyance by the company till such time the transfer actually takes place or a valid no objection is received from the Transferee on his receiving replacement.

(v) Every time an introducing broker replaces a bad delivery share or pays for the share to the receiving broker/buyer investor as per market norms, a No Objection Certificate to transfer the shares in the name of introducing member from the receiving broker/buyer investor shall be given to the introducing member broker/seller investor, as applicable, through the Bad Delivery Cell mechanism.

(C) Duplicate Share Certificate

§ See Notes under section 84.

Jurisdiction for Investor Guidance, Grievances and complaints

Non-receipt of Share Certificates after transfer/transmission/conversion/endorsement/splitting.—A complaint lies before the new SEBI Forum. For the format of the complaint and addresses of the forum, see *Appendix* 234.

Jurisdiction of Consumer Forum

The definition of the word 'goods' as it appeared in MRTP Act, 1969 was amended by the Amendment Act of 1991 with effect from 27-9-1991 so as to provide that goods would include 'shares and stock' including issue of shares before allotment. Thus matters relating to unfair and restrictive trade practices in respect of allotment of shares and stock can go before the M.R.T.P. Commission.

One of the effects of this amendment is the decision of Union Territory Consumer Commission at Chandigarh in *Indian Acrylics Ltd. v. Rajni Goyal,* (1997) 14 SCL 93 (UTCDRC—Chd). The Commission held that shares are a marketable commodity and therefore a purchaser of shares who has filed with the company his application for transfer with payment of transfer fee has paid service charges and is therefore entitled to proceed against the company under the Consumer Protection Act, 1986, s. 2(1)(d) for any deficiency in service.

§ See also Notes under S. 10 under the heading "Jurisdiction of Consumer Forum and its powers to provide interim relief".

Power of Central Government to extend time [Sub-section (1-D)]

Factors for consideration.—The concerned authority is not required to apply its mind to any other matter except the matter of hardship to the applicant in case the time is not extended. The hardship required to be seen is the hardship to the transferee. It is not necessary to hear the transferor before forming an opinion as to whether it is necessary to extend time and the principles of natural justice will not apply. *Vishnu Dayal Jhunjhunwalla v. Union of India,* (1989) 66 Com Cases 684, 693 (All).

No Provision for Appeal or Review.—In the *Vishnu Dayal* case cited above the court also noted that as against an order extending time under this sub-section no appeal or review is provided in the Act, nor has the Central Government any say in the matter, even if there has been a wrong extension of time.

Extension of time for registering transfer to be supported by reasons

Department Clarification.—In seeking extension of time for registering transfer of share under sub-section (1D) of section 108, applicants often adduce various reasons such as over-sight, ignorance of law, misplacement of documents, or ill-health *etc.*, which are vague and not fully convincing. The Company Law Board has, however, at the initial stage of this change in the law, been liberally granting extensions of the period of validity in respect of instruments of transfer for acceptance by the companies concerned to prevent hardship to members of the public, as the provisions were new and were intended to restrict a practice which had been in vogue for a long time. As these provisions of the Act have been in force more than three years now and the legal provisions should have become sufficiently known, it is expected that the law would be more strictly complied with. It should be noted that extension of time for registration of shares would henceforth be granted only in cases of real hardship and where there are valid reasons for the delay in delivering instruments of transfer to the companies concerned. As such, the applications for extension of time under section 108(1D) should be supported by specific reasons indicating the hardships which the applicant is likely to suffer in case of non-registration of shares or refusal of permission for extention of time. The public are advised to take note of the statutory provisions in this regard, seek the

advice of recognised sharebrokers in time and ensure presentation of the instruments of transfer to the companies within the time limit prescribed by law. (*Press Note*, dated 6th May, 1969).

Note.—After the prescription of Form 7-C for application under this section, it seems that this press note has become insignificant as all the required information is now contained in the form. However, the applicant may, for the sake of caution, indicate the reasons relating to the hardships referred to in the notes.

Simplifications of procedure

Department's instruction.—A large number of applications are received by ROCs from the investors seeking extension of time in lodging the share transfer deeds with the company under the above provisions. It is seen that during the period from April, 1993 to March, 1994, 1,72,145 such applications were considered by ROCs including the cases brought forward from 1992-93, out of which 1,54,927 applications were disposed of and on 31-3-1994, 17,218 applications were still pending. In bigger offices, about 2,000 such applications are received in a month. In the past, the Department had advised ROCs to deal with these applications across the table. However, in view of the large intake, ROCs have not been able to deal with these applications expeditiously. Scrutiny of such applications do not take much time as the office has only to ensure payment of application fee and whether the applicant or the company concerned is within the jurisdiction of that office. As per the existing practice, a standard letter is issued to the transferee by registered post along with the impugned transfer deed, extending the time upto one month from the date of issue, and a copy of the letter is also endorsed to the company concerned. This itself is a time consuming process. It has now been decided that instead of issuing the letter, only an endorsement may be made by rubber stamp on the transfer deed itself. In view of this simplified procedure, it should be possible that the required endorsement be made by the Registrar/Assistant Registrar, the same day of receipt of application and returned to the investor concerned across the table. (Para xv). [*Circular No.* 1/95; *F.No.* 14/6/94—CL-V, dated 16-2-1995 *issued by DCA.*]

Application in Form 7-C.—The restrictions of periods mentioned in sub-sections (1-A), (1-B) and (1-C) can be relaxed by the Central Government on an application made to it in this behalf by such further time as it may deem fit. The application in Form No. 7C with effect from 22-4-1988 may be made before or after expiry of such periods. The powers under this sub-section is to be exercised by the Central Government when it is of the opinion that it is necessary to extend the periods mentioned in sub-sections (1-A), (1-B) and (1-C) to avoid hardships.

Application Fee payable by individuals for Transfer of Shares.—The fees payable by investors for extension of time under Section 108(1D) of the Companies Act is at Rs. 50 if the face value of the shares involved in a transfer does not exceed Rs. 5000/-. In case the face value of the shares involved in a transfer exceeds Rs. 5,000/-, the fees payable is Rs. 100 *vide* Rule 2(2), Table II of the Companies (Fees on Application) Rules, 1999 (w.e.f. 10-8-1999).

§ For the text of the Rules, see *Appendix* 5.

Delegation of power to Registrar.—The powers of the Central Government under this sub-section have been delegated to the Registrars of Companies. This power can be exercised by the Registrar of the State in which the registered office of the company is situated or by the Registrar of the State in which the transferee ordinarily resides. (*Notification GSR No.* 507(E), dated 24-6-1985, *as amended by GSR No.* 481(E), dated 22-4-1988).

Government Companies exempted.—This section does not apply to a Government Company in respect of shares held by nominees of Government. (*Notification* GSR 597(E), dated 16-7-1985). See also Notes under S. 620.

Secretarial Action Points for refusal of transfers

1. As a result of the consequential amendment of the section by the Depositories Act, 1996, the section has became confined in its application to companies outside the depository mode. Under S. 111A, the shares of a public company are freely transferable. Private and Deemed Public companies can refuse a transfer in accordance with the provisions of their articles. Check whether the articles of the company confer the power to refuse transfer of shares.

2. Convene a Board meeting to decide on the refusal to register transfer of shares.

3. Send notice of the refusal giving reasons to the transferee and the transferor or the person lodging the transfer within two months from the date the instrument of transfer was received by the company (along with the share certificate).

4. Where on appeal against the refusal, if the CLB directs that the transfer shall be registered by the company, then give effect to the order within ten days of the receipt of the order. If the CLB directs that the transfer should not be registered, intimate the transferor and transferee accordingly within ten days from the date of such direction.

Secretarial Practice Notes : No Transfer except on production of instrument

(a) Before registering any transfer of shares ensure that:
  (i) the instrument received for transfer of shares in form 7B was duly executed and stamped;
  (ii) the delivery of the instrument was within its validity period;
  (iii) the signature of the transferor agreed with the specimen signature filed with the company;
  (iv) the stamps affixed on the instrument had been duly cancelled.
  (v) the transferee had given the specimen signature on the instrument;
  (vi) in case of partly paid-up shares a notice had been sent to the transferee;
  (vii) the articles permit transfer of fully paid-up shares in favour of a minor through the guardian;
  (viii) the shares were not subjected to any lien unless permitted by articles;
  (ix) the instrument was properly witnessed;
  (x) the power of attorney, if any, under which an instrument was executed, was in order; and
  (xi) RBI's permission obtained if the transfer involved non-resident interest;
  (xii) in case the transfer of shares constitutes 5% or more of the paid-up capital of the company (in case of listed company) Rules 40-A, 40-B of the listing regulation of the Stock Exchange have been complied with by the transferor and transferee;
  (xiii) in case transferee is a body corporate, check whether the provisions of s. 372-A of the Companies Act have been complied with by the transferee company;
  (xiv) check whether the provisions of ss. 108A to 108C apply to the transaction;

(b) If the duly executed instrument was lost, check that:
  (i) the transferee made an application in writing on stamp paper of the required value;
  (ii) indemnity was obtained;

(c) If the Registrar has extended the time for filing an executed Instrument under section 108 (1D) of the Act, whether the said instrument has been delivered to the company within the extended time.

Documents Involved: 1. Share Transfer Forms, 2. Share Transfer Register, 3. Minutes of Board Committee Meeting, 4. Register of Members, 5. Articles, 6. Approval of Regional Director, 7. Notice to Transferee, if any, 8. Power of Attorney, if any, 9. Permission of RBI, if any. Documents showing compliance of ss. 372-A and 108B and 108C.

ICSI Guidance Note on Compliance Certificate (August, 2003)

The ICSI has issued a Check List for issue of Compliance Certificate under proviso to Sec. 383A(1) in respect of the matters specified under Rule 3 of the Companies (Compliance Certificate) Rules, 2001.Paragraph 13 under Rule 3 relates to delivery of securities certificates and dividend and reads as follows:

Paragraph-13.—**The company has:**

(i) delivered all certificates on allotment of securities and on lodgement thereof for transfer/transmission or any other purpose in accordance with the provisions of the Act.

(ii) deposited the amount of dividend declared including interim dividend in a separate bank account on.....which is within five days from the date of declaration of such dividend.

(iii) paid/posted warrants for dividends to all the members within a period of 30 (Thirty) days from the date of declaration and that all unclaimed/unpaid dividend has been transferred to Unpaid Dividend Account of the Company with.....Bank on.....

(iv) transferred the amounts in unpaid dividend account, application money due for refund, matured deposits, matured debentures and the interest accrued thereon which have remained unclaimed or unpaid for a period of seven years to Investor Education and Protection Fund.

(v) duly complied with the requirements of section 217 of the Act.

Prescribed Check List

Transfer and Transmission of Shares [*Item (b)*]

I. Transfer of Shares

Check whether :

(i) the requirements contained in the Articles of Association have been complied with;

(ii) the transfer of shares/debentures and the issue of certificates thereof have been made within the stipulated time under sections 108 and 113 in accordance with the procedures prescribed;

(iii) in respect of transfer deeds reported lost, the company has registered transfer of shares based on an application in writing on stamp paper of the required value with indemnity duly executed by the transferee to the satisfaction of the Board in accordance with the first proviso to section 108 (1);

(iv) transfer applications duly executed by the transferor and transferee completed in all respects are delivered to the company within the validity period mentioned in section 108(1A);

(v) share transfer application is in Form 7B/7BB, as the case may be;

(vi) a notice had been sent to the transferee in case of partly paid shares;

(vii) requisite permission under section 108A, 108B and 108C has been obtained from the Central Government in applicable cases;

(viii) any directions issued by the Central Government under section 108D has been complied with;

(ix) nomination of shares/debentures received under section 109A has been duly noted on relevant registers by the company;

(x) the shares/debentures have not been registered in the name of a firm, HUF, trust (unless registered under Societies Registration Act, 1860), in view of the provisions under section 153;

(xi) certification of transfer was done in accordance with the provisions under section 112. If yes, check whether the certification on the instrument of transfer to the effect "certificate lodged" was done by a duly authorised person; and

(xii) all transfers have been properly included in the Annual Return.

Note : CSP should also verify entries in the register of transfers.

II. Transmission of shares

Check whether:

(a) the shares have been transmitted to the legal representative of the deceased shareholder in the case of death of a sole shareholder and in the case of joint holdings only to the survivor(s);

(b) transmission of shares is effected upon the production of succession certificate or probate or letter of administration or indemnity duly signed by the legal heirs of the deceased or as per procedure stipulated by the Board of directors and/or Articles of Association.

§ For the text of the Companies (Compliance Certificate) Rules, 2001, see *Appendix* 38.

§ For the full text of the Guidance Notes on Compliance Certificate and for Specimen Compliance Certificate Form as issued by ICSI see *Appendix* 312.

[1][**S. 108A. Restriction on acquisition of certain shares.**—(1) Except with the previous approval of the Central Government, no individual, firm, group, constituent of a group, body corporate or bodies corporate under the same management, shall jointly or severally acquire or agree to acquire, whether in his or its own name or in the name of any other person, any equity shares in a public company, or a private company which is a subsidiary of a public company, if the total nominal value of equity shares intended to be so acquired exceeds, or would, together with the total nominal value of any equity shares already held in the company by such individual, firm, group, constituent of a group, body corporate or bodies corporate under the same management exceed twenty-five per cent of the paid-up equity share capital of such company.

(2) Where any individual, firm, group, constituent of a group, body corporate or bodies corporate under the same management (hereinafter in this Act referred to as the acquirer), is prohibited, by sub-section (1), from acquiring or agreeing to acquire except with the previous approval of the Central Government, any share of a public company or a private company which is a subsidiary of a public company, no—

(a) company in which not less than fifty-one per cent of the share capital is held by the Central Government; or

(b) corporation (not being a company) established by or under any Central Act; or

(c) financial institution;

shall transfer or agree to transfer any share to such acquirer unless such acquirer has obtained the previous approval[2] of the Central Government for the acquisition, or agreement for the acquisition, of such share.]

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1. Ins. by MRTP (Amendment) Act, 1991 (w.e.f 27-9-1991); earlier omitted by MRTP (Amendment) Act, 1974.
2. The prescribed application Form is Form No. 7D *vide* Rule 5B(1) of Companies (Central Government's) Genreal Rules & Forms, 1956 inserted *vide* GSR 754(E), dated 26-12-1991 (w.e.f. 26-12-1991) and application fee is Rs. 500/-.

NOTES

Companies (Amendment) Act, 1974

Sections 108A to 108H were originally introduced in the Companies Act, 1956, by the Amendment Act of 1974 to regulate the acquisition and transfer of shares of a body corporate owning any undertaking to which the provisions of Part A of Chapter III of the MRTP Act apply. They were intended to prevent acquisition or take-over of companies leading to further concentration of economic power.

Notes on clause 10 of the Bill which originally provided for insertion of section 108A by the Companies (Amendment) Act, 1974 stated that "Such takeovers are apt to adversely affect the interest of non-controlling shareholders, particularly public financial institutions, who are kept in the dark while secret negotiations are entered into with those having control of a company. The former are deprived of the opportunity of having any shares in a bargain that may prove profitable and are forced to continue with their shares in the company while management passes into un-known or undesirable hands. Stock exchanges have complained about the inadequacy of the existing provisions to prevent such anonymous and clandestine take overs. Suggestions have been received from other knowledgeable quarters as to the need for urgent action to prevent or regulate such takeovers. It is, therefore, proposed to provide for the requirement of Government approval before completion of any takeover either in one transaction or a series of transactions resulting in the acquisition of shareholding in the aggregate of over twenty-five per cent, by a "group" or combine having the common intention of acquiring control over the company concerned. The proposed restrictions will apply to companies having total paid-up capital of not less than Rs. 25 lakhs and private companies which are subsidiaries of such public companies".

The Joint Committee which considered the Bill recommended that the application of these sections should be confined only to companies coming under Part A of Chapter III of the MRTP Act, 1969 and suggested the inclusion of Section 108H with the following note: "The Committee considers it advisable to confine the operation and scope of the proposed section 108A *etc.*, to companies covered by Part A of Chapter III of the MRTP Act, 1969, in view of their particular bearing upon the aspect of concentration of economic power. Section 108H has been substituted to give effect to this view". [*Para* 24(vi) of the *Report*].

Sachar Committee Recommendations.—The Sachar Committee recommended that provisions of sections 108A to 108H in the Companies Act be transferred to the MRTP Act and stated that "the provisions of these sections are apparently applicable, by virtue of the specific provision in section 108H to shares of companies to which provisions of Part A of Chapter III of the MRTP Act apply. Suggestions have been received by the Committee to the effect that since the provisions in these sections are supposed to take care of concentration of economic power, they should be transferred to the MRTP Act. We would, therefore, recommend the transfer of these sections to the MRTP Act. We may in this connection mention that certain lacunae have been pointed out in the proper working of the sections and we are dealing with them in the section of the report dealing with MRTP Act." (*Para* 17.25)

"While on this subject, we would refer to a suggestion made to us by various bodies in relation to sections 108A to 108H of the Companies Act, which were introduced by the acquisition and transfer of shares of a body corporate owning any undertaking to which the provisions of Part A of Chapter III of the MRTP Act apply and that, therefore, the appropriate place for these provisions would be the MRTP Act rather than the Companies Act. There is considerable force in this suggestion and we agree that the provisions of sections 108A to 108D, 108F and 108G should be brought over to the MRTP Act as sections 23A to 23F respectively. The provisions of section 108E which deal with time limit within which the approval of Central Government is to be accorded should be incorpo-

rated in section 30 of the Act as a new sub-section. Opportunity of being heard, as provided for in section 29 of the Act, will necessarily be given to all persons, who are, or may be, interested in the matter, by the Central Government before passing any order under these provisions". (*Para* 20.34).

"At present, approval of the Central Government under these sections of the Companies Act is required in respect of even transfer of shares from one constituent within a group to another in the same group. It has been represented to us that such a requirement is superfluous as such transfer within the group does not lead to any further concentration of economic power of the group as no increase in the hold of the group is involved. We feel that there is some justification in this view and would, therefore, recommend that a suitable provision be incorporated in the Act, while transferring them to the MRTP Act. The provision may be to the effect that nothing in these sections will affect the transfer of shares within the group from one constituent to another provided an intimation of the transfer is given to the Central Government within two months of effecting the transfer (*Para* 20.35).

MRTP (Amendment) Act, 1984

The provisions of sections 108A to 108H of the Companies Act were omitted and incorporated in Chapter III-A (Sections 30A to 30G) of MRTP Act, 1969 by the MRTP (Amendment) Act, 1984, as recommended by the Sachar Committee. On transfer of these provisions, sub-section (2) of section 108A providing for penalty was deleted and substituted by a new sub-section (2) in section 30-B of the MRTP Act providing for prohibition for transfer of any shares by a Government company, statutory corporation or financial institution to the acquirer of shares.

MRTP (Amendment) Act, 1991

The Ordinance was promulgated on 27th September, 1991 to further amend the MRTP Act, 1969 and the Companies Act, 1956. The ordinance was replaced by the MRTP (Amendment) Act, 1991. The MRTP Act has been re-structured and the concept of MRTP undertakings has been removed by omitting sections 20 to 26 of Part A of Chapter III. The provisions of Chapter III-A (Sections 30-A to 30-G) have been re-transferred to the Companies Act as sections 108-A to 108I. Under the MRTP Act, these provisions applied in cases where the acquirer or transferor is (or would be) the owner in relation to an undertaking to which Part A of Chapter III (popularly known as MRTP undertaking) applies, *vide* Section 30A. On transfer to the Companies Act, these provisions now apply where the acquirer or transferor of shares is (or would be) the owner of a dominant undertaking, as defined in section 2(d) of MRTP Act, 1969, or as a result of acquisition of shares, the dominance of the acquirer increases, *vide* section 108G.

On transfer from the MRTP Act, section 30-B has been incorporated as such in the present section 108A in the Companies Act.

§ For the text of the MRTP Act, 1969 as amended upto date see *Appendix* 297.

Competition Act, 2002 (12 of 2003)

This Act has been passed by the Parliament as Act No. 12 of 2003. As and when it comes into force it will have the effect of replacing the MRTP Act, 1969 as also the MRTP Commission. The authority under the Competition Act, has been given the name "Competition Commission of India" (CCI). Some of the provisions of the Act may impinge upon acquisition and transfer of shares.

§ For the text of the Competition Act, 2002. See *Appendix* 299.

Scope of section

The section prohibits any individual, firm, body corporate, group, constituent of a group, or bodies corporate under common management to acquire more than 25% of the paid-up equity share capital of a public company or a private company which is subsidiary of a public company, without the approval of the Central Government. Thus, no ap-

proval is required for acquisition of shares of a private company *simpliciter, i.e.*, a private company which is not a subsidiary of a public company. Likewise, no approval is required when any preference shares are acquired whether or not such shares happen to possess voting right owing to non-payment of dividend thereon as provided in the Companies Act. Even when the shares acquired are equity shares and of a public company or its subsidiary, no approval is required if they do not in the aggregate, along with the existing holding, if any, exceed 25% of its paid-up equity capital.

Where the present holding and the intended acquisition put together would exceed the prescribed limit of 25%, approval of the Central Government would become necessary *Swadeshi Polytex Ltd. v. Swadeshi Mining & Mfg. Co. Ltd.*, (1987) 62 Com Cases 683 (All).

This section applies only if the acquirer of shares is the owner of a dominant undertaking and as a result of acquisition of shares, its dominance is increased. In other words, acquisition of shares of a company engaged in the production of goods in which the acquirer is not dominant, approval of the Central Government under section 108A is not required. This section also applies if the acquirer would be as a result of such acquisition be the owner of a dominant undertaking (Section 108G).

The object of the section is to prevent concentration of economic power and acquisition of controlling interest in the shares of a public company or a private company which is subsidiary of a public company.

Unlike the provisions of sections 108B and 108C which lay down the considerations which should weigh with the Government in deciding the proposals thereunder, section 108A does not lay down any specific parameters on which the Government should base its decision. The Government is free to take into account all relevant considerations as it may deem expedient, and not only the acquisition of controlling interest by the acquirer. In the ultimate analysis, the decision of the Government, if the proposal is rejected, would, however, be tested on the touch-stone of the concept of 'public interest', in terms of concentration of economic power arising out of the proposal and its detrimental effect.

Sub-section (2) has to be read in the context of the exemption contained in section 108F in favour of a Government company, statutory corporation or financial institution. It has been clarified that the Government company or the said institutions shall not transfer any share unless the acquirer has obtained previous approval of the Central Government.

From the examination of the scheme of sections 108A to 108G it is clear that the Parliament thought it fit to curtail the right of the acquirers in certain cases, either in the interests of the company or the public [*sec.* 108B(2), 108D, Companies Act]. Though it is not made express in section 108A, the Central Government while exercising the authority under the said section is obviously required to keep in mind both the two factors, *i.e.*, interests of the company and public. The language and the scheme of section 108D makes the above clear. "Therefore, if the interest of the company is one of the factors to be considered by the Central Government while granting or declining to grant the approval under section 108A or 108D, necessarily the government is required to examine various factors like the impact of the acquisition on the management of the company, whether such an impact is desirable, etc. The existing legal obligation of the company should also be one of the factors. If that is the true import of the scheme of sections 108A to 108G, the company (target) would be equally entitled to at least make an assessment of the probable impact of the registration of the acquisition of the bulk shares by any acquirer on the interests of the company. If in the process the company comes to the conclusion that registering such a transfer would be detrimental to the interests of the company, the company could certainly avail the benefit of section 108D and seek appropriate directions from the Central Government or in the alternative itself take a decision to refuse registration and render itself liable for an appellate scrutiny by the CLB as provided under section 111A(2), *proviso. Karamsad Investment Ltd. v. Nile Ltd.*, (2002) 46 CLA 23 : (2001) 34 SCL 269 : (2002) 108 Com Cases 58 (AP).

Applicability of the section to acquisition of shares of deemed public companies

Note : The concept of deemed public companies [S. 43-A Companies] has been abolished by the Companies Amendment Act, 2000. The case literature on the subject has been retained in the interest of knowledge for handling pending matters.

It is a moot point whether the section applies to acquisition of the equity shares of s. 43-A company. The expression used in sub-s. (1) is "equity shares" in a public company or a private company which is a subsidiary of a public company". Going by the observation of the Supreme Court in *Needle Industries (India) Ltd. v. Needle Industries Newey (India) Holdings Ltd.,* (1982) 1 Comp LJ 1, in para 159 that "the expression public company cannot be equated with a private company which has become a public company by virtue of s. 43-A", it transpires that strictly speaking the provisions of Section 108-A may not apply to the acquisition of the equity shares of a s. 43-A company which again cannot be "equated with the private company which is a subsidiary of a public company". Furthermore, the observation of the Supreme Court in para 165 in the above case reads: "three distinct types of companies occupy a distinct place in the scheme of our Companies Act: (1) private companies (2) public companies and (3) private companies which have become public companies by virtue of s. 43-A, but which continue to include or retain the three characterstics of a private company". Thus, the term "public company" cannot automatically rope in s. 43-A companies under the provisions of the section.

Department's Clarifications with comments

Clarification I.—The bar of section 108A applies even to instances where a shareholder (or a group) already holding more than 25% of the shares in a company seeks to acquire more shares. *Letter No.* 8/2/(Mis)/75-CL-V, dated 6-6-1975 *of the Department of Company Affairs.*

On a plain reading of this section, it is clear that it is intended to prevent persons not holding any share or less than 25% of shares in a company by increasing their holding to more than 25%. This section does not envisage that for further acquisition of shares, which already exceeds 25%, *albeit,* with the Government's approval, any further approval of the Government is required.

Clarification II.—Government's approval under this section is necessary even where a transfer is sought to be made within a 'group' without affecting the holding of the 'group' as a whole. In other words, *inter se* transfer of shares within the constituents of the 'group' will also require Government's approval even though the aggregate group holding remains the same. [*Letter No.* 11/13/76-CL-VI, dated 22-6-1976 *of the Department of Company Affairs*].

The reasoning is not understandable as *inter se* transfer within the group will not accentuate the concentration of economic power and the controlling interest will remain within the same limit.

Clarification III.—In case of rights issue, which does not result in increasing the percentage of shares held by a person, group or a body corporate the provisions of section 30B are not attracted unless as a result of refusal by any existing shareholder to take up his quota of rights shares, the percentage of shares out of rights issue acquired by such person *etc.* increases in the share capital as enhanced. [*Circular No.* 5/78 (*F.No.* 8/19(108)/76-CL-V), dated 5-6-1978]. On the same reasoning, issue of bonus shares will be outside the scope of this section.

In case, the shares pledged with a Bank as security for any loan are redeemed to the transferor, the same cannot be treated as an acquisition of shares within the meaning of section 30B of MRTP Act (now Section 108A), as this amounts to restoration of beneficial interest to the owner thereof. *Swadeshi Mining & Mfg. Co. Ltd. v. Swadeshi Polytex Ltd.,* (1984) 2 Comp LJ 86 (CLB).

SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997

SEBI has issued the above Regulations relating to Substantial Acquisition of Shares and Takeovers to provide greater transparency in the acquisition of shares and the takeover of companies through a system of disclosure of information.

§ For the text of the SEBI Regulations (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, refer *Appendix* 177.

Acquisition without prior permission

In *Gujarat Machinery Manufacturers Ltd. v. Nile Ltd.,* (2001) 105 Com Cases 817 : (2000) 5 Comp LJ 340 : 2001 CLC 649 : (2001) 40 CLA 1 (CLB—Chennai), it was

found that the acquisition of shares was in violation of the section because prior permission of the Central Government was not taken. Refusal by the company to accept the transfer of shares was held to be justified. The appeal against the refusal under s. 111A was rejected because sub-s. (3) of that section justifies refusal where the transaction in shares is in violation of any law for the time being in force.

The decision of the CLB in *Gujarat Machinery Manufacturers Ltd. v. Nile Ltd., (Supra)* was **partly reversed** by the AP High Court in *Karamsad Investments Ltd. v. Nile Ltd.*, (2002) 108 Com Cases 58 : (2002) 1 Comp LJ 251 : (2002) 46 CLA 23 (AP). It is the date of the intention to acquire which is material and not the date of the agreement with the seller. Hence, the date of passing of the resolution is crucial. The holding company was already holding shares in the target company. Its subsidiary company passed a resolution for acquiring shares of the target company. This acquisition alongwith the shares of the holding company exceeded the prescribed limits. The subsidiary was bound to obtain prior permission of the Central Government. It was held that because of the failure to obtain the necessary permission, the target company was entitled to refuse to register the transfer. It was also held that an acquisition of 5% or more had to be disclosed. The acquirer having not done so was bound to be penalised.

Section 15-H of the SEBI Act and Regulations 10, 2(1)(b) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 1997 contain the relevant provisions. Acquisition of shares was under a pledge by directors of their shares of the company against loans taken by them. The total shares involved constituted 16.24% of the paid up capital of the company. Some of the shares were transferred to others and some others remained in the name of the borrowers. It was held that only such shares had to be reckoned for computing 10% bench mark as were actually registered with the company and in respect of which the shareholder could exercise voting rights. *Ch Kiron Margadarai Financeirs v. Adjudicating Officer,* 2002 CLC 27 (SEBI—Mumbai).

Time-limit for conveying approval

In terms of section 108E, the Central Government is obliged to convey its decision, approving or rejecting the proposal within 60 days from the date of receipt of the proposal. In the event of the failure on the part of the Central Government to do so, it shall be presumed that the approval sought, has been granted.

Penalty for default.—Section 108I(1) provides penalty for contravention of section 108A.

Compoundable offence.—The offence is compoundable under section 621A.

Expressions used under the section

Under section 108H, the following expressions used in the section shall have the meaning assigned to them in the MRTP Act, 1969, *viz.*:

Section 2(d)	—	'dominant undertaking'
Section 2(da)	—	'financial institution'
Section 2(ef)	—	'group'
Section 2(g) Explanation I	—	'under the same management'
Section 2(ja)	—	'owner'

The other expressions used in the section like 'body corporate', 'public company', 'equity shares' *etc.* shall have the meaning assigned to them under the Companies Act, 1956.

Relevant Rules and Prescribed Form.—Every application for seeking approval of the Central Government shall, be in Form No. 7D prescribed under the Companies (Central Government's) General Rules and Forms, 1956 accompanied by a fee of Rs. 500, *Appendix* 1.

Secretarial Practice Notes

Check whether the acquirer of shares is a dominant undertaking under section 2(d) of the MRTP Act, 1969 and its dominance increases or not. If so, check whether shares have been acquired after seeking Government's approval.

Documents involved: (1) Form No. 7D, (2) Approval of the Central Government.

[1][**S. 108B. Restriction on transfer of shares.**—(1) Every body corporate, or bodies corporate under the same management, holding, whether singly or in the aggregate, ten per cent or more of the nominal value of the subscribed equity share capital of any other company, shall, before transferring one or more of such shares, give to the Central Government an intimation of its or their proposal to transfer such share, and every such intimation shall include a statement as to the particulars of the share proposed to be transferred, the name and address of the person to whom the share is proposed to be transferred, the share holding, if any, of the proposed transferee in the concerned company and such other particulars as may be prescribed.[2]

(2) Where, on receipt of an intimation given under sub-section (1) or otherwise, the Central Government is satisfied that as a result of such transfer, a change in the composition of the Board of Directors of the company is likely to take place and that such change would be prejudicial to the interests of the company or to the public interest, it may, by order, direct that—

(a) no such share shall be transferred to the proposed transferee:

Provided that no such order shall preclude the body corporate or bodies corporate from intimating, in accordance with the provisions of sub-section (1), to the Central Government its or their proposal to transfer the share to any other person, or

(b) where such share is held in a company engaged in any industry specified in Schedule XV, such share shall be transferred to the Central Government or to such corporation owned or controlled by that Government as may be specified in the direction.

(3) Where a direction is made by the Central Government under clause (b) of sub-section (2), the share referred to in such direction shall stand transferred to the Central Government or to the corporation specified therein and the Central Government or the specified corporation, as the case may be, shall pay, in cash, to the body corporate or bodies corporate from which such share stands transferred, an amount equal to the market value of such share, within the time specified in sub-section (4).

Explanation.—In this sub-section, 'market value' means, in the case of a share which is quoted on any recognised stock exchange, the value quoted at such stock exchange on the date immediately preceding the date on which the direction is made, and, in any other case, such value as may be mutually agreed upon between the holder of the share and the Central Government or the specified cor-

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1. Ins. by MRTP (Amendment) Act, 1991 w.e.f. 27-9-1991.
2. Prescribed Form of Intimation is Form No. 7E *vide* Rule 5B(3) of Companies (Central Government's) General Rules & Forms, 1956 inserted *vide* GSR 754(E), dated 26-12-1991 (w.e.f. 26-12-1991) and intimation fee is Rs. 500/-.

poration, as the case may be, or in the absence of such agreement, as may be determined by the court.

(4) The market value referred to in sub-section (3) shall be given forthwith, where there is no dispute as to such value or where such value has been mutually agreed upon, but where there is a dispute as to the market value, such value as is estimated by the Central Government or the corporation, as the case may be, shall be given forthwith and the balance, if any, shall be given within thirty days from the date when the market value is determined by the court.

(5) If the Central Government does not make any direction under sub-section (2) within sixty days from the date of receipt by it of the intimation given under sub-section (1), the provisions contained in sub-section (2) with regard to the transfer of such share shall not apply.]

NOTES

Companies (Amendment) Act, 1974

Section 108B was originally inserted by the Companies (Amendment) Act, 1974. Notes on clauses of the Bill stated: "New section 108B provides that every body corporate or bodies corporate, holding whether singly or in the aggregate, ten per cent or more of the nominal share capital of any company, shall intmiate to the Government any proposal to transfer such shares. On receiving such intimation, the Central Government is empowered to issue directions regulating the transfer of such shares. In respect of companies operating in the fields covered by Industries enumerated in the Schedule, the Central Government may direct the shares to be transferred to the Central Government or such corporation owned or controlled by that Government as may be specified in the direction. It is also proposed to regulate the terms for acquiring the shares so directed to be transferred and in case of disagreement the same shall be settled by the Court." (Clause 10: para 2).

The *Joint Committee of the Parliament,* with a view to make the provisions less harsh, made some modifications in the Companies (Amendment) Bill as follows: "The section stipulates restriction on the transfer of shares. The Committee feel that provisions of section 108B should not affect the liquidity of shares and the period of restriction on the transfer of shares might be limited to sixty days and where any transfer to the proposed transferee is not approved by the Central Government, it would be open to the company to give a fresh intimation with a proposal to transfer the share to any other transferee. Sub-section has been amended accordingly. The Committee feel that the payment of market value of shares should be made forthwith where there is no dispute as to the market value,or shares should be made forthwith agreed upon. But where there is a dispute as to the market value, the value as estimated by the Central Government or the Corporation shall be paid forthwith and the balance may be paid within thirty days from the date of determination of the market value by the Court. Accordingly a new sub-section (4) has been inserted in section 108B" (*Report: Para* 24(ii)).

MRTP (Amendment) Act, 1984

This section was omitted in the Companies Act and transferred as section 30-C in the MRTP Act by the MRTP (Amendment) Act, 1984, with the only change that the penalty provision contained in sub-section (6) was deleted. The penalty provision was contained in section 48B of the MRTP Act.

MRTP (Amendment) Act, 1991

This section has again been incorporated under the Companies Act after the omission of section 30-C in the MRTP Act, by the Amending Act of 1991 with effect from 27th

September, 1991. The Schedule to the MRTP Act has been replaced by a new Schedule XV in the Companies Act, referred to in section 108B(2)(b). The industries covered by Schedule XV are reserved for public sector under the Industrial Policy Statement of 1991. Also see legislative changes under section 108A.

§ For the text of the MRTP Act, 1969 amended upto-date, see *Appendix* 297.

Scope of section

This section provides that every body corporate or bodies corporate under the same management holding 10% or more of the subscribed equity share capital of any company shall intimate to the Central Government of any proposal for transfer of such shares. Transfer of preference shares does not come within the purview of this section. The transfer of any shares by any one, except a body corporate, is also outside the purview of this section. This section applies in case the transferor is (or would be as a result of such transfer) a dominant undertaking, as defined in section 2(d) of the MRTP Act, 1969.

The Central Government is empowered to order that no such shares shall be transferred, or the shares in a company engaged in any industry covered by the Schedule to the Act shall be transferred to the Central Government or to such corporation owned or controlled by that Government as may be specified in the directions. The shares so transferred to the Government or the corporation shall be subject to payment in cash, equal to the market value of shares as determined by Central Government or as mutually agreed upon. The market value can be determined by the Court, in case of any dispute.

Inter se transfer of shares between bodies corporate under the same management is also covered by this section, if the holding of the transferor body (bodies) corporate is 10% or more of the subscribed equity share capital of the transferee company.

When a body corporate or bodies corporate under the same management holding more than 10% shares in aggregate transfer such shares to a scheduled Bank as security against loan, intimation under section 108B to the Central Government is necessary. [*Circular No.* 8/2(MISC.)/75 CL-V, dated 6-6-1975, *issued by Department of Company Affairs.*] The Circular runs counter to the views expressed in *Swadeshi Mining Co. v. Swadeshi Polytex Ltd.*, (1984) 2 Comp LJ 86 (CLB).

The provisions of the section are not applicable to a banking company. A complaint for any violation of the section will be only at the instance of the Central Government or RBI. *Kanchanlal Hiralal Nanavati v. R. Prabhu,* (1984) 55 Com Cases 6 (Mad).

Time-limit for sanction by the Government [Sub-section (5)]

In case, no direction is received by the applicant body corporate within 60 days of the date of receipt of its intimation by the Government, it would be free to transfer the shares as proposed.

Considerations to weigh with Government in deciding the proposal

The Central Government does not have an unlimited discretion to refuse to acknowledge an intimation given under this section. The Government's power to refuse is circumscribed by two factors, *viz.*, (i) that the proposal may cause a change in the composition of the Board of Directors of the company concerned, and (ii) that such change would be prejudicial to the interest of the company or to the public interest. Any other consideration would not be a valid basis for rejection of the intimation given under this section.

Penalty for default.—Contravention of this section is punishable under sub-sections (2) and (4) of Section 108I.

Compoundable offence.—The offences are compoundable by the Central Government under section 621A, except those covered by section 108-I(4)(a).

Relevant rules and prescribed form.—Every intimation to the Central Government under this section be made in a Form No. 7E prescribed under the Companies (Central

Government's) General Rules & Forms, 1956 accompanied by a fee of Rs. 500. See *Appendix* 1.

Secretarial Practice Notes

Check whether the transferor is a dominant undertaking as defined in section 2(d) of the MRTP Act, 1969. If so, whether intimation has been given to the Central Government.

Ensure compliance of direction given by the Central Government, if any.

Documents involved: 1.Form No. 7E, 2. Acknowledgment of intimation by the Central Government.

[1][**S. 108C. Restriction on the transfer of shares of foreign companies.**—No body corporate, or bodies corporate under the same management, which holds, or hold in the aggregate ten per cent or more of the nominal value of the equity share capital of a foreign company, having an established place of business in India, shall transfer any share in such foreign company to any citizen of India or any body corporate incorporated in India except with the previous approval[2] of the Central Government and such previous approval shall not be refused unless the Central Government is of opinion that such transfer would be prejudicial to the public interest].

NOTES

Companies (Amendment) Act, 1974

Section 108C was originally inserted by the Companies (Amendment) Act, 1974. The need for this section was stated in the notes on clauses in the Companies (Amendment) Bill in the following words: "By new section 108C the restrictive provisions are made applicable to transfer of shares of foreign bodies corporate having an established place of business in India in cases where holding of shares is ten per cent or more of the nominal share capital of the foreign company concerned. In this way it is intended to meet the situations which have come to the notice of the Government of companies which are incorporated outside India but having substantial business in India changing hands, and funds derived from such transfers being misused for obtaining control over other Indian companies. It is expected that the Government becoming aware of such changes will be in a position to ensure that they are in public interest".

The Joint Committee of the Parliament made some modifications as regards the scope of application of the section with the explanation, thus; "Section 108C stipulates restriction on the transfer of shares of foreign bodies corporate having an established place of business in India in cases where holding of shares is 10 per cent or more of the nominal share capital of the foreign company concerned, except with the previous approval of the Central Government. The Committee feel that the approval of the transfer of shares should not be refused unless it is prejudicial to the public interest. The Committee also feel that the scope of the section should be limited to transfer of holdings of shares by bodies corporate and should not cover transfers of holding by individuals". [*Reports*: Para 24(iii)].

MRTP (Amendment) Act, 1984

This section was omitted in the Companies Act and transferred to the MRTP Act, 1969 as section 30-D by the MRTP (Amendment) Act, 1984.

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1. Ins. by MRTP (Amendment) Act, 1991, w.e.f. 27-9-1991.
2. Prescribed Form of Application for Approval is Form No. 7E *vide* Rule 5B(3) of Companies (Central Government's) General Rules & Forms, 1956 inserted *vide* GSR 754(E), dated 26-12-1991 (w.e.f. 26-12-1991) and application fee is Rs. 500/-.

MRTP (Amendment) Act, 1991

This section has again been incorporated under the Companies Act after the omission of section 30-D in the MRTP Act, by the Amending Act of 1991 w.e.f. 27-9-1991. Also see Legislative History under section 108A.

§ For the text of the MRTP Act, 1969, amended upto date see *Appendix* 297.

Scope of Section

Under this section, transfer of any share of any foreign company held by a body corporate or bodies corporate under the same management, when the aggregate holding is 10% or more, of the nominal value of the equity share capital has been prohibited, except with the previous approval of the Central Government. The prohibition applies to transfer of shares to any Indian citizen or to a body corporate incorporated in India. In other words, a transfer of shares to a foreign national or to a foreign body corporate falls outside the purview of this section. A foreign company for the purposes of this section, is one which has established a place of business in India, and to which Part XI of the Companies Act, 1956 applies.

Approval of the Central Government is required when the transferor is (or would be) the owner of a dominant undertaking.

The Central Government can refuse its approval, only on the ground that the proposed transfer would be prejudicial to public interest. Any other consideration cannot form valid basis for rejection of the proposal by the Government.

Time-limit for decision by Government

By virtue of the provisions of section 108E, the proposal for transfer of shares under this section is required to be disposed of, by the Government within 60 days of the date of receipt of the proposal. If it is not so done, the approval of the Government is to be presumed.

Penalty for default.—Section 108I(3) provides for penalty for contravention of section 108C. The offence is compoundable by the Central Government under section 621A.

Relevant Rules and prescribed form.—Every intimation to the Central Government under this section be made in a Form No. 7E prescribed under the Companies (Central Government's) General Rules and Forms, 1956 accompanied by a fee of Rs. 500. See *Appendix* 1.

Secretarial Practice Notes

Check whether the transferor is a dominant undertaking as defined in section 2(d) of the MRTP Act, 1969. If so, whether approval of the Central Government has been obtained.

Documents involved: 1. Form No. 7E, 2. Approval of the Central Government.

[1][**S. 108D. Power of Central Government to direct companies not to give effect to the transfer.**—(1) Where the Central Government is satisfied that as a result of the transfer of any share or block of shares of a company, a change in the controlling interest of the company is likely to take place and that such change would be prejudicial to the interests of the company or to the public interest, that Government may direct the company not to give effect to the transfer of any such share or block of shares and—

(a) where the transfer of such share or block of shares has already been registered, not to permit the transferee or any nominee or proxy of the transferee, to exercise any voting or other rights attaching to such share or block of shares; and

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1. Inserted by MRTP (Amendment) Act, 1991, w.e.f. 27-9-1991.

(b) where the transfer of such share or block of shares has not been registerd, not to permit any nominee or proxy of the transferor to exercise any voting or other rights attaching to such share or block of shares.

(2) Where any direction is given by the Central Government under sub-section (1), the share or the block of shares referred to therein shall stand retransferred to the person from whom it was acquired, and thereupon the amount paid by the transferee for the acquisition of such share or block of shares shall be refunded to him by the person to whom such share or block of shares stands or stand retransferred.

(3) If the refund referred to in sub-section (2) is not made within the period of thirty days from the date of the direction referred to in sub-section (1), the Central Government shall, on the application of the person entitled to get the refund, direct, by order, the refund of such amount and such order may be enforced as if it were a decree made by a civil court.

(4) The person to whom any share or block of shares stands or stand retransferred under sub-section (2) shall, on making refund under sub-section (2) or sub-section (3), be eligible to exercise voting or other rights attaching to such share or block of shares.]

NOTES

Companies (Amendment) Act, 1974

Section 108D was originally inserted by the Companies (Amendment) Act, 1974. Clause 10 (para 4) of the notes on clauses of the Bill stated: "By section 108D, it is proposed to empower Central Government to direct companies not to give effect to any transfer of shares if as a result of such transfer, a change in the controlling interest of the company concerned, prejudicial to the interests of the company or public interest, is likely to take place. It is proposed that the power will extend to a restoration of the *status quo ante*". Sub-section (4) was added by the Joint Committee of the Parliament with the following explanatory note: "The section freezes the voting right in respect of the shares or block of shares in relation to which any direction has been made by the Central Government. The Committee feel that voting rights should not be frozen for all times. Accordingly, sub-section (4) has been added, which provides, that on the retransfer of the shares to the seller, he should have voting and other rights in respect of the shares, provided he has refunded the purchase money to the purchaser".

MRTP (Amendment) Act, 1984

This section was omitted in the Companies Act and transferred to the MRTP Act, 1969 as Section 30-E by the MRTP (Amendment) Act, 1984.

MRTP (Amendment) Act, 1991

This section has again been incorporated under the Companies Act after the omission of section 30-E in the MRTP Act, by the Amending Act of 1991 w.e.f. 27-9-1991. Also see Legislative changes under section 108A.

§ For the text of the MRTP Act, 1969 amended upto date see *Appendix* 297.

Scope of section

Section 108D is generally worded in the sense that its scope is not confined to the cases covered by sections 108A and 108B. The coverage of this section, indeed, is much wider when compared to section 108A, inasmuch as it does not exclude acquisition of shares, by transfer thereof, even of a private company *simpliciter, i.e.*, to say which is not a subsidiary of a public company. However, in view of the governing section 108G, the acquirer must be a dominant undertaking or would, as a result of such acquisition or transfer of shares, become the owner of a dominant undertaking.

Controlling interest

Section 108D speaks of 'change in the controlling interest of the company'. The expression 'controlling interest' has not been defined in the MRTP Act. This expression has also not been defined in the Companies Act, 1956. Also, no *quantitative* norm has been laid down in this regard, unlike in section 2(g) of MRTP Act for determination of inter-connection of an undertaking. The expression 'controlling interest' appears in *Explanation-I* to section 2(ef) of MRTP Act which defines a 'group', a perusal whereof shows that the two expressions 'controlling interest' and 'control' are not synonymous expressions. Controlling interest in relation to a company, in its normal sense, would mean control of voting power to the extent of over 50 per cent; in other words, it would mean ownership of over 50 per cent of the equity share capital. Thus, controlling interest referred to in this section has a legal connotation. While control for purposes of section 2(ef) which defines group and for purposes of section 2(g) which lays down the concept of inter-connection, could be *de facto* control and not necessarily *de jure* control (which is based on control of over 50 per cent of the voting power in a company), this would not be so for the purpose of section 108D. To elaborate further, while factum of 'control' can be gathered from all the surrounding circumstances and it need not be confined to one single element of corporate control, namely, exercise of voting right, 'controlling interest' for the purpose of section 108D, however, has to be determined with reference to *de jure* control, *i.e.*, to say holding of over 50 per cent of the equity share capital, (or the equity and preference capital, if the latter happens to possess voting right owing to the dividend thereon being in arrear, by virtue of section 87 of the Companies Act, 1956).

No directions have so far been given under this section by the Central Government since its introduction in the Companies Act in 1974 and thereafter in the MRTP Act in 1984. On a plain reading of the provisions of this section and when the same is contrasted with the provisions of sections 2(g) and 2(ef), it would appear that the transfer of any share or block of shares should result in a change of controlling interest, meaning thereby acquisition of over 50 per cent of the capital carrying voting right. If the transfer of shares does not result in acquiring over 50 per cent of such capital, there would be no change in the controlling interest and hence the provisions of this section would, then, be inapplicable. It is only when the shares which are acquired along with the shares already held constitute over 50 per cent of the capital (equity or equity and preference as the case may be) of the company, then only a direction could flow from the Government not to give effect to the transfer of share or block of shares.

Under this section, the Central Government is empowered to direct the company concerned, not to give effect to the transfer of any share, if it is satisfied that the transfer is likely to bring about a change in the controlling interest of the company, and that such change would be prejudicial to the interest of the company or to the public interest. 'Prejudicial to the interests of the company' includes not only detriment to the company or its undertaking, but also to the general body of shareholders of the company. Unless both the conditions, as aforestated, are satisfied, a transfer of controlling interest, by itself, is not objectionable.

Exercise of voting rights and refund of consideration paid

In case the transfer of share has been registered, the Government may by order prohibit the transferee or his nominee or proxy to exercise any voting rights or other rights attached to such shares. On retransfer of shares, the consideration amount is refundable by the transferee. In case, no refund is made within 30 days of the direction given by the Government, necessary orders can be passed to enforce recovery, and it may then be executed as a decree of a Civil Court.

Order to be passed on sufficent material and opportunity of hearing

A reasonable opportunity of being heard is *sine qua non* to any *quasi*-judicial order. Such an opportunity would, therefore, be a pre-requisite before an order is passed by the Gov-

ernment under Section 108D. *Vijay Kumar Berlia v. Union of India,* (1982) 52 Com Cases 437. Not only that, it is necessary that the order of the Central Government is a speaking order, clearly detailing the facts and circumstances as specified in sub-section (1) of this section, which has justified the imposition of the restraint. It was further held that an order under this section is drastic in nature because it prohibits the implementation of a transaction for transfer of shares and therefore it is necessary that it should be based upon sufficient material. The section does not envisage the Central Government passing a temporary order pending a final disposal of the case.

Penalty for default.—Section 108I(4) provides for penalty for contravention of section 108D. While the offence under clause (a) of section 108I(4) is not compoundable, the offence under clause (b) thereof is compoundable under section 621A.

Secretarial Practice Notes

Ensure compliance of the direction given by the Central Government, if any.

[1][**S. 108E. Time within which refusal to be communicated.**—Every request made to the Central Government for according its approval to the proposal for the acquisition of any share referred to in section 108A or the transfer of any share referred to in section 108C shall be presumed to have been granted unless, within a period of sixty days from the date of receipt of such request, the Central Government communicates to the person by whom the request was made, that the approval prayed for cannot be granted.]

NOTES

Companies (Amendment) Act, 1974

Section 108E was originally inserted by the Companies (Amendment) Act, 1974, because the Joint Committee felt that "if the approval of the Central Government under section 108A or 108C is not granted within sixty days it should be presumed to have been given". [*Report*: para 24(v)]

MRTP (Amendment) Act, 1984

This section was omitted in the Companies Act and transferred to the MRTP Act, 1969 as Section 30-F by the MRTP (Amendment) Act, 1984.

MRTP (Amendment) Act, 1991

This section has again been incorporated under the Companies Act after the omission of section 30-F in the MRTP Act, by the Amending Act of 1991 w.e.f. 27-9-1991. Also see Legislative History under section 108A.

§ For the text of the MRTP Act, 1969 amended upto date see *Appendix* 297.

Scope of section

A time-limit of 60 days has been statutorily prescribed in section 108E; within which the decision on the proposal for acquisition of shares under section 108A or transfer of shares under section 108C, should be taken by the Central Government. A similar time-limit has been prescribed under section 108B. In case, no communication rejecting the proposal is received by the applicant within the aforestated period, it would be presumed that the approval has been granted by the Government.

In Section 108E (which relates to proposals under sections 108A and 108C) and in section 108B, there is no provision for permitting the extension of the time-limit within which the proposals may be disposed of by the Central Government, when further par-

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1. Ins. by MRTP (Amendment) Act, 1991, w.e.f. 27-9-1991.

ticulars are sought from the applicant. The cases falling under these sections are required to be decided by the Government within 60 days of the date of receipt of such proposals. If the rejection of the proposal is not conveyed within the said time-limit of 60 days, as statutorily prescribed, it may be presumed by the applicant that the proposal has been approved by the Government. The footnote in *Forms No.* 7D and 7E relating to proposals under sections 108A, 108B and 108C, which reads as follows: "If this application is incomplete in any respect, the deficiency will be pointed out to the applicant and the period of 60 days mentioned in section 108E of the Act will count from the date from which such deficiency is set right", it seems, cannot override the substantive provisions contained in section 108E. In *Swadeshi Polytex Limited v. Swadeshi Mining and Manufacturing Co. Ltd.,* (1987) 62 Com Cases 683; it was held that if the communication of the Central Government only sought additional information but did not point out any deficiency in the application, there was no question of extending the period of 60 days. In other words, the aforecited footnote would have no application unless the Central Government had pointed out any deficiency in the application.

[1][**S. 108F. Nothing in sections 108A to 108D to apply to Government companies,** *etc.*—Nothing contained in section 108A [except sub-section (2) thereof] shall apply to the transfer of any share to and nothing in section 108B or section 108C or section 108D shall apply to the transfer of any share by—

(a) any company in which not less than fifty-one per cent of the share capital is held by the Central Government;

(b) any corporation (not being a company) established by or under any Central Act;

(c) any financial institution].

NOTES

Companies (Amendment) Act, 1974

This section was orginally inserted as section 108G by the Companies (Amendment) Act, 1974. See Legislative History under section 108A.

MRTP (Amendment) Act, 1984

This section was omitted from the Companies Act and transferred to the MRTP Act as section 30-G by the MRTP (Amendment) Act, 1984.

MRTP (Amendment) Act, 1991

This section has again been incorporated as section 108F under the Companies Act after the omission of section 30-G in the MRTP Act by the Amending Act of 1991 w.e.f. 27-9-1991.

§ For the text of the MRTP Act, 1969 amended upto date see *Appendix* 297.

Scope of section

This section exempts any Government company, statutory corporation and any financial institution from the applicability of the provisions of sections 108-A, 108B, 108C and 108D. The provisions of sub-section (2) of section 108A have, however, been made applicable to them. Earlier, under section 3 of the MRTP Act, the provisions of that Act did not apply to them. However, *vide* G.S.R. No. 605(E), dated 27th September, 1991, the exemption available to them has been withdrawn.

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1. Ins. by MRTP (Amendment) Act, 1991, w.e.f. 27-9-1991.

It may be noted that penalty provisions of section 108-I(1) are confined to the acquirer and not to the transferor of shares.

Government company has been defined in section 617 of the Companies Act, 1956 and the term 'financial institution' has been defined in section 2(da) of the MRTP Act. The corporations like LIC, UTI have been established by Acts of Parliament. Significantly, the exemption under section 108F is not available to an undertaking, the management of which has been taken over by the Government.

[1][**S. 108G. Applicability of the provisions of sections 108A to 108F.**—The provisions of sections 108A to 108F (both inclusive) shall apply to the acquisition or transfer of shares or share capital by, or to, an individual, firm, group, constituent of a group, body corporate, or bodies corporate under the same management, who, or which—

(a) is, in case of acquisition of shares or share capital, the owner in relation to a dominant undertaking and there would be, as a result of such acquisition, any increase—

(i) in the production, supply, distribution or control of any goods that are produced, supplied, distributed or controlled in India or any substantial part thereof by that dominant undertaking, or

(ii) in the provision or control of any services that are rendered in India or any substantial part thereof by that dominant undertaking, or

(b) would be, as a result of such acquisition or transfer of shares or share capital, the owner of a dominant undertaking; or

(c) is, in case of transfer of shares or share capital, the owner in relation to a dominant undertaking.]

NOTES

Companies (Amendment) Act, 1974

Section 108H was originally inserted by the Companies (Amendment) Act, 1974, which reads as under: "References in sections 108A, 108B, 108C and 108D to shares or share capital, as the case may be, shall be construed as references to shares or share capital, respectively, of a body corporate owning any undertaking to which the provisions of Part A of Chapter III of the MRTP Act, 1969, apply."

This section was inserted by the Joint Committee of Parliament, for the following reasons: "The Committee considers it advisable to confine the operation of the scope of proposed section 108A, *etc.* to companies covered by Part A of Chapter III of the MRTP Act, 1969, in view of their particular bearing upon the aspect of concentration of economic power. Section 108H has been substituted to give effect to this view". [*Report* : Para 24(vi)].

Companies (Amendment) Act, 1977

Section 108H was amended by the Companies (Amendment) Act, 1977 to provide that reference to 'same management' shall be construed as a reference to the same expression defined in section 2(g) of the MRTP Act, 1969.

MRTP (Amendment) Act, 1984

Section 108H was omitted from the Companies Act and a new section 30A was incorporated in the MRTP Act by the MRTP (Amendment) Act, 1984. While adopting

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1. Ins. by MRTP Amendment Act, 1991, w.e.f. 27-9-1991.

section 30A in the MRTP Act, the scope of the operative sections 30B to 30E in Chapter III-A was widened. Section 30-A provided that the provisions of Chapter III-A shall apply to the acquisition or transfer of shares by, or to, an individual, firm, group, constituent of a group, body corporate, or bodies corporate under the same management, who or which,—

(a) is the owner in relation to an undertaking to which Part A of Chapter III applies, or

(b) would be, as a result of such acquisition or transfer of shares or share capital, the owner of an undertaking to which Part A of Chapter III applies, or would apply.

The position, in this regard, stands explained in clause 23 in Notes on Clauses on the MRTP (Amendment) Bill, 1983 in the following words: "clause 23 seeks to introduce a new chapter, namely, Chapter III-A, dealing with restrictions on the acquisition and transfer of shares of, or by, certain bodies corporate. The existing provisions of sections 108A to 108G of the Companies Act, 1956, are proposed to be incorporated in this Chapter. Simultaneously, the corresponding provisions in the Companies Act are proposed to be omitted. It is, of course, proposed not to incorporate the provisions of section 108H of the Companies Act which restrict the provisions for acquisition and transfer of shares only to MRTP companies. Under the provisions, as introduced, any company to which Part A of Chapter III of the Act applies, will be required to obtain approval of the Central Government for acquisition and transfer of shares of MRTP as well as non-MRTP companies".

MRTP (Amendment) Act, 1991

Section 30A in the MRTP Act has been omitted and incorporated in the Companies Act as section 108G by the Ordinance promulgated on 27-9-1991. While transferring this provision to the Companies Act, a significant change in the governing section 108G has been made. Under section 30A, approval of the Central Government was required in cases where the acquirer or transferor is the owner (or as a result of such acquisition would be the owner) in relation to an undertaking to which Part A of Chapter III of the MRTP Act applies. Since Part A of Chapter III has been omitted in the MRTP Act, 1969 by the Ordinance, under the provisions of section 108G, the approval of the Government was required where the acquirer or transferor is a dominant undertaking as defined in section 2(d) of the MRTP Act. Section 108G was amended by the MRTP (Amendment) Act, 1991 to provide that approval of the Central Government is required in case the acquisition of shares or share capital by the dominant undertaking has the effect of increase in its dominance.

§ For the text of the MRTP Act, 1969 amended upto date see *Appendix* 297.

Scope of section

This section governs the scope of the provisions of sections 108A to 108D.

Sections 108A to 108G (except section 108C) refer to shares or share capital and, therefore, the applicability of these provisions is confined to acquisition or transfer of shares of an Indian Company, within the meaning of section 3 of the Companies Act, 1956. Section 108C also speaks of share or share capital, but of a foreign company, *i.e.*, a company falling within the purview of Part XI of the Companies Act. If the shares of any of the companies, as aforestated, are traded by way of acquisition or transfer, and if the acquirer or transferor, as the case may be, is covered by the provisions of section 2(d) of MRTP Act, approval of the Central Government would be required. Such acquirer or transferor, may be an individual, firm, body corporate, or constituent of a group. 'Group' has been defined in section 2(ef) of MRTP Act and it includes trust and trustees; 'associated persons' as defined in the *Explanation* to the said section are also deemed to be constituent of a group.

Conversely, if the shares of a company are acquired by, or transferred to, any individual, firm or body corporate which at the time of acquisition or transfer of such shares is outside the purview of section 2(d) of the MRTP Act, then approval of the Central Government would not be necessary.

Opportunity of hearing to applicant

There is no provision in section 108G or in any of the preceding sections for a hearing to be given to the applicant before the Central Government takes final decision on the proposal made to it, and in particular when the proposal is rejected. But, keeping in view the principles of natural justice, a hearing would be warranted, and a speaking order would be necessary, if the Central Government decides to reject the proposal made under any of these provisions. Failure on the part of the Central Government to do so, may enable the applicant to invoke the writ jurisdiction of the Supreme Court or the High Court under Article 32 or 226 of the Constitution.

[1][**S. 108H. Construction of certain expressions used in sections 108A to 108G.**—The expressions, "group", "same management", "financial institution", "dominant undertaking" and "owner" used in sections 108A to 108G (both inclusive), shall have the meanings respectively assigned to them in the Monopolies and Restrictive Trade Practices Act, 1969.]

NOTES

Companies (Amendment) Act, 1977

Section 108H, inserted by the Companies (Amendment) Act, 1974, was amended by the Amendment Act of 1977 to provide that the expression 'same management' be construed as defined in section 2(g) of the MRTP Act, 1969.

MRTP (Amendment) Act, 1984

Section 108H was omitted in the Companies Act by the MRTP (Amendment) Act, 1984. Since the provisions of sections 108A to 108G were omitted and incorporated in the MRTP Act, 1969 in Chapter III-A thereof, there was no need to retain this provision.

MRTP (Amendment) Act, 1991

The provisions of Chapter III-A (Sections 30-A to 30-G) have been omitted and retransferred to the Companies Act. Section 108H has now been incorporated in the Companies Act as some of the expressions used in the provisions of Sections 108A to 108G are relevant to the definition clauses in section 2 of the MRTP Act, 1969.

§ For the text of the MRTP Act, 1969 amended upto date, see *Appendix* 297.

Scope of section

While the expressions like public company, share, share capital, body corporate, *etc.* used in sections 108A to 108G will have the meaning assigned to them in the Companies Act, section 108H provides that the following expressions defined in the MRTP Act will be taken into account for purposes of these sections:

Definition	Section of the MRTP Act
Dominant undertaking	2(d)
Financial Institution	2(da)
Group	2(ef)
Under the same management	2(g), *Explanation I*
Owner	2(ja)

1. Ins. by MRTP (Amendment) Act, 1991, w.e.f. 27-9-1991.

These definitions are relevant for purposes of sections 108A to 108G and not for other provisions of the Act.

[1][**S. 108-I Penalty for acquisition or trasfer of share in contravention of sections 108A to 108D.**—(1) Any person who acquires any share in contravention of the provisions of section 108A shall be punishable with imprisonment for a term which may extend to three years, or with fine which may extend to [2][*fifty thousand rupees*], or with both.

(2) (a) Every body corporate which makes any transfer of shares without giving any intimation as required by section 108B, shall be punishable with fine which may extend to [2][*fifty thousand rupees*].

(b)Where any contravention of the provisions of section 108B, has been made by a company, every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years, or with fine which may extend to [2][*fifty thousand rupees*], or with both.

(3) (a) Every body corporate which makes any transfer of shares in contravention of the provisions of section 108C, shall be punishable with fine which may extend to [2][*fifty thousand rupees*].

(b) Where any contravention of the provisions of section 108C has been made by a company, every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years, or with fine which may extend to [2] [*fifty thousand rupees*], or with both.

(4) (a) Every person who transfers any share in contravention of any order made by the Central Government under section 108B, or gives effect to any transfer of shares made in contravention of any direction made by the Central Government under section 108D, or who exercises any voting right in respect of any share in contravention of any direction made by the Central Government under section 108D, shall be punishable with imprisonment for a term which may extend to five years, and shall also be liable to fine.

(b) If any company gives effect to any voting or other right exercised in relation to any share acquired in contravention of the provisions of section 108B, or which gives effect to any voting right in contravention of any direction made by the Central Government under section 108D, the company shall be punishable with fine which may extend to five thousand rupees, and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years, or with fine which may extend to [2][*fifty thousand rupees*], or with both.]

NOTES

Companies (Amendment) Act, 1974

Section 108F was incorporated in the Companies Act by the Amendment Act of 1974 providing for penalty for contravention of sections 108A, 108B and 108C. Penalties were also provided in sections 108A(2), 108B(6) and 108C(2).

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1. Ins. by MRTP (Amendment) Act, 1991, w.e.f. 27-9-1991.
2. The words "five thousand rupees" substituted by the Companies (Amendment) Act, 2000 (53 of 2000), s. 44 (w.e.f. 13-12-2000).

MRTP (Amendment) Act, 1984

This section was omitted from the Companies Act and incorporated as section 48B of the MRTP Act, by the MRTP (Amendment) Act, 1984. The penalty provisions were consolidated in one section (Section 48B).

MRTP (Amendment) Act, 1991

Section 108-I has been incorporated in the Companies Act and corresponds to section 48B in the MRTP Act on its omission by the Amending Act of 1991, w.e.f. 27-9-1991.

§ For the text of the MRTP Act, 1969 amended upto date, see *Appendix* 297.

Companies (Amendment) Act, 2000

Penalty enhanced.—The Amendment Act of 2000 enhanced the penalty amount under following sub-sections:

1. From 5,000 rupees to 50,000 rupees under sub-section (1).
2. From 5,000 rupees to 50,000 rupees under sub-section (2)(a).
3. From 5,000 rupees to 50,000 rupees under sub-section (2)(b).
4. From 5,000 rupees to 50,000 rupees under sub-section (3)(a).
5. From 5,000 rupees to 50,000 rupees under sub-section (3)(b).
6. From 5,000 rupees to 50,000 rupees under sub-section (4)(b).

Scope of section

The penalties provided in this section are severe to act as a deterrent. The offences were not compoundable, when these provisions were under the MRTP Act, in the absence of any enabling provision in this behalf. On transfer of these provisions to the Companies Act, by virtue of provisions of section 621A, the offences covered by section 108-I are compoundable by the Central Government, except the penalty provision contained in section 108-I(4)(a) which provides for compulsory imprisonment.

S. 109. Transfer by legal representative.—A transfer of the share or other interest in a company of a deceased member thereof made by his legal representative shall, although the legal representative is not himself a member, be as valid as if he had been a member at the time of the execution of the instrument of transfer.

NOTES

Eng. Act, 1948 : Sec. 76 Previous Act : Secs. 34 to 37
Eng. Act, 1985 : Sec. 183(3)

Companies (Amendment) Act, 2000

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*]

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*].

Scope of section

The section empowers the legal representative of a deceased member to transfer the shares by following the prescribed procedure provided for transfer of shares.

The section does not dispense with proof of the fact that the person claiming to be the legal representative is in fact the legal representative and for this purpose a succession certificate or other legal evidence must be produced, if the company requires such proof. The executor of a deceased person is his legal representative for all purposes and all the property of the deceased vests in him as such. Therefore, the right to the shares and other interests of the deceased member in a company devolves on the executor of the deceased by operation of law as distinguished from *inter vivos* transfer. *Hemendra Prasad Barooah v. Bahadur Tea Co. P. Ltd.*, (1991) 70 Com Cases 792, 795 (Gau). Legal representative of a deceased member is not to be regarded as a member unless his name is entered in the register of members. [*Ibid* at p. 794].

The shares held by a lunatic cannot be transferred without an order of the court. *New York Security Trust Co. v. Keyser*, (1901) 1 Ch 606.

Transmission of shares

§ See Notes under section 108 *ante*.

Secretarial Practice Notes : Transfer by legal representative

Before registering any transfer made by the legal representative of the deceased, check whether following documents had been obtained:

(i) succession certificate or probate or letter of administration and in case of small holdings, indemnity bond and affidavit on non-judicial stamp paper;

(ii) certified copy of the death certificate;

(iii) specimen signatures of the successors to the shares;

[Refer: Regulations 25 to 28 of Table A of Schedule I to the Companies Act, 1956.]

Documents Involved: Succession Certificate/ Probate/Letter of Administration.

[1][*S. 109A. Nomination of shares.—(1) Every holder of shares in, or holder of debentures of, a company may, at any time, nominate, in the prescribed manner*[2]*, a person to whom his shares in, or debentures of, the company shall vest in the event of his death.*

(2) Where the shares in, or debentures of, a company are held by more than one person jointly, the joint holders may together nominate, in the prescribed manner, a person to whom all the rights in the shares or debentures of the company shall vest in the event of death of all the joint holders.

(3) Notwithstanding anything contained in any other law for the time being in force or in any disposition, whether testamentary or otherwise, in respect of such shares in, or debentures of, the company, where a nomination made in the prescribed manner purports to confer on any person the right to vest the shares in, or debentures of, the company, the nominee shall, on the death of the shareholder or holder of debentures of, the company or, as the case may be, on the death of the joint holders become entitled to all the rights in the shares or debentures of the company or, as the case may be, all the joint holders, in relation to such shares in, or debentures of the company to the exclusion of all other persons, unless the nomination is varied or cancelled in the prescribed manner.

(4) Where the nominee is a minor, it shall be lawful for the holder of the shares, or holder of debentures, to make the nomination to appoint, in the pre-

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1. Ins. by the Companies (Amendment) Act, 1999 (w.e.f. 31-10-1998).
2. Prescribed Form No. is 2B *vide* Rule 4CCC and 5D of the Companies (Central Government's) General Rules and Forms, 1956 *vide* GSR 754(E), dated 24-10-2000.

scribed manner, any person to become entitled to shares in, or debentures of, the company, in the event of his death, during the minority.]

NOTES

Companies (Amendment) Act, 1999

Facility for nomination.—This section has been inserted by the Companies (Amendment) Act, 1999 to provide for nomination facility in respect of shares and debentures. Earlier, the absence of any such provision in the Act created hardship to the survivors or successors of deceased members or debenture-holders. In case of a joint-holder, Regulation 25 of Table A in Schedule 1 to the Act provides that on the death of a member, the surviving member or members shall be the only persons recognised by the company as having any title to the interest in shares. The surviving member, in case of companies which had adopted the said regulation in their articles, was able to get the shares registered in his name on production of death certificate in respect of the deceased shareholder. However, for transmission of shares held by a single member in favour of legal heir(s), the procedure involved to obtain probate, letters of administration of succession certificate is very time-consuming and expensive. Under the extant provisions of section 109A, the shareholder or debenture-holder may now avail of the facility to nominate any person to whom his shares or debentures shall vest in the event of his death.

Similar facility is also available to deposit holders under section 58A(11).

Press Release, dated 23-07-1999.—Under the Companies (Amendment) Act, 1999, the shareholders have been allowed to nominate a person for their shares, debentures and deposits. The form in which the nomination has to be filed has been notified by the Department of Company Affairs under the amended Companies Act. Earlier, holders of shares and debentures in a company did not enjoy the nomination facility for shares, debentures and deposits, which caused hardships to them. They were required to obtain a letter of succession from the competent authority. The facility of nomination is intended to make the company law in tune with the present day economic policies of liberalization and deregulation. This is also intended to promote investors confidence in capital market and to promote the climate for inter-corporate investment in the country. [*PIB Press Release, New Delhi, dated July 23, 1999*]

Nature, manner and extent of nomination

Relevant Rules and prescribed form.—In terms of Rule 5D of the Companies (Central Government's) General Rules & Forms, 1956 (*Appendix 1*), the nomination has to be made in Form 2B prescribed for the purpose.

The following position emerges from the provision made in this section and Form 2B:

(1) Nomination can be made only by individuals applying/holding shares or debentures on their own behalf. Non-individuals including society, trust, body corporate, firm, karta of HUF, and holder of power of attorney cannot nominate. If the shares are held jointly, all joint holders (only upto 2 persons) may nominate. Thus, nomation can be in respect of shares or debentures held by persons in their individual capacity and not in any representative capacity.

(2) Nominee can only be an individual and not more than one can be nominated. A trust, society, body corporate, partnership firm, karta of HUF or power of attorney holder cannot be appointed as a nominee of a shareholder or a debenture-holder. A Non-resident Indian (NRI) can be a nominee on repatriable basis.

(3) Nominations stand automatically rescinded on transfer of shares/debentures.

(4) A minor can be nominated, in which case his/her date of birth and the name and address of the guardian must be stated in the nomination form. In terms of sub-section (4), in the event of the death of the shareholder or debentureholder during the minority of the nominee , the guardian shall become entitled to the shares or debentures in question. However, on attaining majority, the minor will become entitled to the shares or debentures in the event of death of the original holder.

(5) Nominee will become entitled to shares or debentures in the event of death of the shareholder or debentureholder as the case may be, on production of death certificate or such evidence as may be required by the company's Board of Directors, to the exclusion of his legal heirs under the Law of Succession, in view of *non-obstante* clause in sub-section (4).

(6) Nomination may be varied or cancelled at any time (for which no separate form has been prescribed). The nomination may be varied or cancelled by writing to the company. For change in the name of the nominee it would be in order to cancel the existing nomination and make a fresh nomination.

(7) *Nomination is optional.*—In the absence of any nomination or cancellation of the existing nomination, the legal heirs of the deceased shareholder or debenture holder shall become entitled to the shares or debentures, as the case may be. In that event, the company may insist for production of probate, letters of administration or succession certificate; or such evidence as may be deemed fit by the Board.

(8) The nomination form be signed by the shareholder or debentureholder in the presence of 2 independent witnesses.

(9) In case the nominee dies, it is open to the shareholder or debentureholder to nominate a fresh nominee, otherwise the shares or debentures will devolve on the legal heirs of the deceased shareholder or debentureholder.

(10) Nomination may also be made in respect of partly paid shares. In the event of death of the shareholder and on becoming entitled to the shares, the nominee steps into the shoes of the original shareholder and will be liable for payment of calls made by the company.

(11) The prescribed form 2B does not provide for signature of the nominee, witness of his signature, Folio No. or share certificate No. in question. The company may require such particulars to be given in the Nomination Form. Although not so stated, it would be useful if the particulars of the nominee are stated in the register of members/debentureholders appropriately.

(12) Investors holding shares in dematerialised form are also entitled to nominate a person who will become entitled to the shares in the event of death of the original shareholder.

(13) Transfer of shares/debentures in favour of a nominee shall be a valid discharge against the legal heirs of the deceased share/debenture holder. The company is fully protected against claim from legal heirs.

(14) The position as stated above shall also apply *mutatis mutandis* to the depositors in terms of section 58A(11).

(15) *Filing of nomination.*—Nomination in prescribed form 2B shall be filed *in duplicate* with the company or Registrar/Share Transfer Agents of the company, who will return one copy of the form to the shareholder or debenture holder.

Nomination facility for unitholders in Mutual Fund

Reg. 29A of SEBI (Mutual Funds) Regulations, 1996 requires the asset management company to provide an option to the unitholder to nominate a person in whom all the rights in the units shall vest on the event of his death, in the prescribed form. Joint holders of the units may together nominate one person.

[1][*S. 109B. Transmission of shares.—(1) Any person who becomes a nominee by virtue of the provisions of section 109A, upon the production of such evidence*

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1. Ins. by the Companies (Amendment) Act, 1999 (w.e.f. 31-10-1998).

as may be required by the Board and subject as hereinafter provided, elect, either—

(a) to be registered himself as holder of the share or debenture, as the case may be; or

(b) to make such transfer of the share or debenture, as the case may be, as the deceased shareholder or debenture holder, as the case may be, could have made.

(2) If the person being a nominee, so becoming entitled, elects to be registered as holder of the share or debenture, himself, as the case may be, he shall deliver or send to the company a notice in writing signed by him stating that he so elects and such notice shall be accompanied with the death certificate of the deceased shareholder or debenture holder, as the case may be.

(3) All the limitations, restrictions and provisions of this Act relating to the right to transfer and the registration of transfers of shares or debentures shall be applicable to any such notice or transfer as aforesaid as if the death of the member had not occurred and the notice or transfer were a transfer signed by that shareholder or debenture holder, as the case may be.

(4) A person, being a nominee, becoming entitled to a share or debenture by reason of the death of the holder shall be entitled to the same dividends and other advantages to which he would be entitled if he were the registered holder of the share or debenture except that he shall not, before being registered a member in respect of his share or debenture, be entitled in respect of it to exercise any right conferred by membership in relation to meetings of the company:

Provided that the Board may, at any time, give notice requiring any such person to elect either to be registered himself or to transfer the share or debenture, and if the notice is not complied with within ninety days, the Board may thereafter withold payment of all dividends, bonuses or other moneys payable in respect of the share or debenture, until the requirements of the notice have been complied with.]

NOTES

Companies (Amendment) Act, 1999

This section has been inserted by the Companies (Amendment) Act, 1999 in regard to transmission of shares and debenture for which nominaiton is made pursuant to section 109A.

Rights of Nominee

In the event of death of the original shareholder or debentureholder, the nominee becomes entitled to the shares or debentures. Under sub-section (1), the nominee has two options, either to get the shares/debentures registered in his/her name or to seek transfer thereof. If he/she elects to register the shares/debentures in his/her name, then he/she should send a notice in writing to the company in this behalf, as provided in sub-section (2), along with death certificate of the original shareholder/debentureholder and the shares or debenture certificate in question so that the same are transmitted in his/her name. In case he/she elects to transfer the impugned shares/debentures, he/she should submit to the company, in the capacity as a transferor, the transfer deed duly stamped and executed by him/her and the transferee in compliance of the provisions of section 108.

As per sub-sections (3) and (4), the nominee steps into the shoes of the deceased member/debenture holder and enjoys all the rights and privileges and shall be subject to all the limitations and obligations under the Act. He/she shall be entitled to dividend, bonus and rights shares and will be entitled to exercise right to vote in respect of the shares transmitted to his/her name. As a debentureholder, he will be entitled to seek redemption of debenture on the date of maturity along with interest. As a member/debentureholder, he/she will also have a right to transfer the shares/debentures under the Act.

In case the nominee fails to give notice to the company under sub-section (2), the Board of directors of the company on coming to know of the death of the shareholder/debenture holder, may give notice to the nominee to elect either to be registered as a member/debentureholder or to transfer the shares/debentures. As per proviso to sub-section (4), if the notice is not complied with by the nominee within 90 days, the Board may withhold payment of dividend, bonus shares or money payable, as the case may be, until the notice is complied with.

S. 110. Application for transfer.—(1) An application for the registration of a transfer of the shares or other interest of a member in a company may be made either by the transferor or by the transferee.

(2) Where the application is made by the transferor and relates to partly paid shares, the transfer shall not be registered, unless the company gives notice of the application to the transferee and the transferee makes no objection to the transfer within two weeks from the receipt of the notice.

(3) For the purposes of sub-section (2), notice to the transferee shall be deemed to have been duly given if it is despatched by pre-paid registered post to the transferee at the address given in the instrument of transfer, and shall be deemed to have been duly delivered at the time at which it would have been delivered in the ordinary course of post.

NOTES

Eng. Act, 1948 : Sec. 77
Eng. Act, 1985 : Sec. 183(4)

Previous Act : Sec. 34

Companies (Amendment) Act, 2000

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*]

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*].

Scope of section

The notice to the transferee should be sent by registered post.

When a transfer is registered, it relates back to the time when the transfer was made. *Howrah Trading Co. Ltd. v. CIT*, AIR 1959 SC 775 : (1959) 29 Com Cases 282.

In the case of a blank transfer, while as between the transferor and transferee, equities may arise, the company is not affected as long as the name of the transferee is not in the register. (*Ibid*).

Splitting of joint holding of shares

In the case of joint shareholders, where they want splitting of the joint holding of shares and registering portions of them in their individual names as sole owners, an instrument of transfer is necessary for registering in each case. The instrument of transfer will have to be executed by all the joint holders as transferors and by the individual in whose sole name any shares are to be registered as the transferee, as the process of conversion of joint ownership into separate ownership necessarily involves a transfer. *Cf. Hemalata Saha v. Stadmed (P.) Ltd.*, AIR 1965 Cal 436 : (1964) 34 Com Cases 875.

Secretarial Practice Notes : Application for transfer

(a) In case of transfer of partly paid-up shares, check whether notice of application of transfer was duly given to the transferee, if application made by transferor?

(b) Check whether no objection was received from the transferee within 2 weeks from the date of receipt of such notice before registering the transfer.

Documents Involved: 1. Share transfer register, 2. Minutes of Board/Committee Meeting, 3. Order of Company Law Board, if any, 4. Form 21, 5. Articles, 6. Register of Members.

[1][**S. 111. Power to refuse registration and appeal against refusal.**—(1) If a company refuses, whether in pursuance of any power of the company, under its articles or otherwise, to register the transfer of, or the transmission by operation of law of the right to, any shares or interest of a member in, or debentures of, the company, it shall, within two months from the date on which the instrument of transfer, or the intimation of such transmission, as the case may be, was delivered to the company, send notice of the refusal to the transferee and the transferor or to the person giving intimation of such transmission, as the case may be, giving reasons for such refusal.

(2) The transferor or transferee, or the person who gave intimation of the transmission by operation of law, as the case may be, may appeal to the [2][*Tribunal*] against any refusal of the company to register the transfer or transmission, or against any failure on its part within the period referred to in sub-section (1), either to register the transfer or transmission or to send notice of its refusal to register the same.

(3) An appeal[3] under sub-section (2) shall be made within two months of the receipt of the notice of such refusal or, where no notice has been sent by the company, within four months from the date on which the instrument of transfer, or the intimation of transmission, as the case may be, was delivered to the company.

(4) If—

(a) the name of any person—

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1. Subs. s. 111 by the Companies (Amendment) Act, 1988, (w.e.f. 31-5-1991) *vide* GSR dated 31-5-1991, for the original section 111.
2. **Subs. for "Company Law Board" by the Companies (Second Amendment) Act, 2002 (11 of 2003), s. 15.**
3. With fee of Rs. 500/- under CLB (Fees on Application & Petitions) Rules, 1991. See *Appendix* 6.

(i) is, without sufficient cause, entered in the register of members of a company, or

(ii) after having been entered in the register, is, without sufficient cause, omitted therefrom; or

(b) default is made, or unnecessary delay takes place, in entering in the register the fact of any person having become, or ceased to be, a member [including a refusal under sub-section (1)],

the person aggrieved, or any member of the company, or the company, may apply[4] to the [5][*Tribunal*] for rectification of the register.

(5) The [5][*Tribunal*], while dealing with an appeal[4] preferred under sub-section (2) or an application made under sub-section (4) may, after hearing the parties, either dismiss the appeal or reject the application, or by order—

(a) direct that the transfer or transmission shall be registered by the company and the company shall comply with such order within ten days of the receipt of the order; or

(b) direct rectification of the register and also direct the company to pay damages, if any, sustained by any party aggrieved.

(6) The [5][*Tribunal*], while acting under sub-section (5), may, at its discretion, make—

(a) such interim orders, including any orders as to injunction or stay, as it may deem fit and just;

(b) such orders as to costs as it thinks fit; and

(c) incidental or consequential orders regarding payment of dividend or the allotment of bonus or rights shares.

(7) On any application under this section, the [5][*Tribunal*]—

(a) may decide any question relating to the title of any person who is a party to the application to have his name entered in, or omitted from, the register;

(b) generally, may decide any question which it is necessary or expedient to decide in connection with the application for rectification.

(8) The provisions of sub-sections (4) to (7) shall apply in relation to the rectification of the register of debenture-holders as they apply in relation to the rectification of the register of members.

(9) If default is made in giving effect to the orders of the [5][*Tribunal*] under this section, the company and every officer of the company who is in default shall be punishable with fine which may extend to [6][ten thousand rupees], and with a further fine which may extend to [7][one thousand rupees] for every day after the first day after which the default continues.

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4. With fee of Rs. 500/- under CLB (Fees on Application & Petitions) Rules, 1991. See *Appendix* 6.
5. **Subs. for "Company Law Board" by the Companies (Second Amendment) Act, 2002 (11 of 2003), s. 15.**
6. The words "one thousand rupees" substituted by the Companies (Amendment) Act, 2000, (53 of 2000) s. 45 (w.e.f. 13-12-2000).
7. The words "one hundred rupees" substituted by the Companies (Amendment) Act, 2000, (53 of 2000) s. 45 (w.e.f. 13-12-2000).

(10) Every appeal or application to the [8][*Tribunal*] under sub-section (2) or sub-section (4) shall be made by a petition in writing and shall be accompanied by such fee as may be prescribed.

(11) In the case of a private company which is not a subsidiary of a public company, where the right to any shares or interest of a member in, or debentures of, the company is transmitted by a sale thereof held by a Court or other public authority, the provisions of sub-sections (4) to (7) shall apply as if the company were a public company:

Provided that the [8][*Tribunal*] may, in lieu of an order under sub-section (5), pass an order directing the company to register the transmission of the right unless any member or members of the company specified in the order acquire the right aforesaid within such time as may be allowed for the purpose by the order, on payment to the purchaser of the price paid by him therefor or such other sum as the [8][*Tribunal*] may determine to be a reasonable compensation for the right in all the circumstances of the case.

(12) If default is made in complying with any of the provisions of this section, the company and every officer of the company who is in default, shall be punishable with fine which may extend to [9][five hundred rupees] for every day during which the default continues.

(13) Nothing in this section and section 108, 109 or 110 shall prejudice any power of a private company under its articles to enforce the restrictions contained therein against the right to transfer the shares of such company.]

[10][(14)In this section 'company' means a private company and includes a private company which had become a public company by virtue of section 43A of this Act].

NOTES

Eng. Act, 1948 : Sec. 78.
Eng. Act, 1985 : Sec. 183(5), (6).

General Note : As and when the Companies (Second Amendment) Act, 2002 (11 of 2003) comes into force, the power under this section shall become transferred to the Tribunal to be exercised by it in place of the Company Law Board. The commentary should be read keeping this change in mind.

Sachar Committee's Recommendations

The provisions of the Act relating to transfer of shares attracted the attention of Sachar Committee. In para 7.21, Sachar committee made the following recommendations: "(1) Many public companies whose scrips are listed on the stock exchange do not generally refuse registration of transfer of their shares. Since shares are movable property, they ought to be freely transferable. Whilst it may still be necessary to retain and recognize the right of directors to refuse registration of transfers if so authorised by a company's Articles of Association, this right, we think, should be hedged in with adequate safeguards. Under the law as it stands, the company is not immediately required to give reasons for refusal to register transfers and it is only the right of the final adjudication body [under section 111(5A)] to require the company to disclose its reasons at an appellate stage.

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8. **Subs. for "Company Law Board" by the Companies (Second Amendment) Act, 2002 (11 of 2003), s. 15.**
9. The words "fifty rupees" substituted by the Companies (Amendment) Act, 2000, (53 of 2000) s. 45 (w.e.f. 13-12-2000).
10. Ins. by the Depositories Act, 1996 (w.e.f. 20-9-1995).

This, in our opinion, is unsatisfactory. Under the existing law, there are two remedies open to an aggrieved person—to file an appeal under section 111, or to apply to the Court for rectification of the share register under section 155. We think that these two remedies should now be assimilated and provision be made (at one place) for a person aggrieved (including any person aggrieved by a refusal of the Board of Directors to register a transfer or transmission of shares) to apply to the Company Law Board—as proposed to be constituted—for rectification of the share register on any of the grounds mentioned in sub-clause (a) or (b) of sub-section (1) of the present section 155.

Our proposals are—

Accordingly, we would recommend as follows:

(a) Sections 111 and 155 should be assimilated into a single statutory provision;

The existing provisions of sections 111 (4A) and 111(8) dealing with prescribing fees on appeals and transmission of shares of private companies by Court sale or other public authority should be retained."

Companies (Amendment) Act, 1988

Bond on the recommendations of Sachar Committee, the Amendment Act of 1988 assimilated the provisions of sections 111 and 155 and conferred the powers of the Court under section 155 on the Company Law Board statutorily, as also the powers of the Central Government under section 111. Notes on clauses of the Bill stated:

"Clause 16—This clause seeks to recast the existing section 111 by incorporating therein the provisions of section 155, which confers powers of the High Court to order rectification of the register of members. With a view to providing adequate protection to investors against refusal to register transfer of shares, this clause requires companies to give reasons before they refuse any transfer of shares. It also confers rights on the aggrieved investor to apply for relief to the Company Law Board (instead of the High Court) on specified grounds."

"Clause 21 seeks to delete sections 155 and 156. This is consequent upon the amendment proposed in clause 16 of the Bill."

Depositories Act, 1996

Sub-section (14) was added to this section by way of a consequential amendment introduced by the Depositories Act, 1996. The new sub-section provides that for the purposes of S. 111 a company means a private company including a private company which becomes public by operation of S. 43-A. The effect of the amendment is that in case of public companies to which the Depositories Act would apply, instead of S. 111, section 111A would apply which has also been introduced as a consequential amendment by the Depositories Act, 1996.

The Company Law Board has held that any petition filed after the implementation of the above amendment would be affected by it even if the cause of action arose earlier to the effective date of the amendment. Accordingly CLB refused to provide any relief under a cause of action which arose in 1994, for which a petition was filed after the effective date. The CLB said that the jurisdiction is applicable as on the date of the filing and not as on the date of cause of action. *Shashi Prakash Khemka v. NEPC Micon Ltd.*, (1997) 90 Com Cases 228: (1997) 4 Comp LJ 265 (CLB—Mad). The Company Law Board has held that if a petition in respect of a public company happened to be filed under S. 111, it would be automatically treated as filed under S. 111A. *Bhuwaneshwar Nath Nigam v. Hindustan Lever Ltd.*, (2002) 111 Com Cases 590 : (2002) 49 CLA 85 : (2002) 38 SCL 124 (CLB).

Among contradictory authorities, this much is clear that the Company Law Board is not a court so as to attract the Limitation Act, 1963. Sub-s. (4) which empowers the Company Law Board to order rectification of register of members prescribes no period of its own for an application for rectification. Hence, no period of limitation is operative under sub-section (4). Subsequently, when s. 111A was introduced by the Amendment of 1997, it

prescribed the period of two months. In a matter before the Company Law Board, at the time when the cause of action arose (before the insertion of s. 111-A) there was no period of limitation. The Company Law Board allowed the petition. The period of limitation of two months prescribed by s. 111A would operate prospectively. The petitioners' name was removed from the register of members. They came to know of it in May 1995. They filed the petition in December 1995. The Company Law Board dismissed it saying that it had no jurisdiciton in respect of a public company. *Shashi Prakash Khemka v. NEPC Micon Ltd.,* (1997) 90 Com Cases 228 (CLB). The Company Law Board was authorised by the amendment even in respect of public companies where the act of the company is in violation of any law for the time being in force. The limitation period of two months prescribed by s. 111A(3) would not apply to pre-existing causes. An amendment cannot take away vested rights. Accordingly, when in January 1997 the jurisdiction in respect of public companies was restored for some limited purposes, the petitioners applied again. The petition was held to be maintainable. *Sashi Prakash Khemka v. NEPC Micon Ltd.,* (1999) 95 Com Cases 583 : (1999) 1 Comp LJ 502 : (1999) 32 CLA 33 (CLB—SB). The ruling of the CLB in this case that S. 111A applied only to transfer matters and not to transmissions was **not approved** by the Bombay High Court in *Finolex Industries Ltd. v. Anil Ramchand Chhabria,* (2000) 26 SCL 233 (Bom). The court also noted the fact that the proviso to sub-s. (2) which was also brought in by the amendment prescribes no period of limitation of its own.

Condonation of delay before Amendment Act, 1988.—Before the Amendment Act, 1988, this power under section 111 was vested in the Central Government (delegated to the CLB).

Under section 637-B the Central Government has power to condone any delay. Though that section does not expressly mention appeals, as the expression 'application' is wide enough to include 'appeal' also, as construed by the Privy Council in *Nagendra Nath Dey v. Suresh Chandra Dey,* AIR 1932 PC 165, there is no reason why the word 'application' in section 637-B should not be construed as including 'appeal' also. The Company Law Board in Appeals Nos. 5 to 12 of 1972 (*Madanlal Patodia v. Lakshmi Narayan Cotton Mills Ltd.*) **followed** the above Privy Council construction, as regards appeals under this section.

Companies (Amendment) Act, 2000

Penalty enhanced.—The Amendment Act of 2000 has enhanced the amount of fine:

(1) for failure to give effect to the order of the Company Law Board from 1,000 rupees to 10,000 rupees, and from 100 rupees to 1000 rupees for everyday after the first day for the continuing default, under sub-section (9); and,

(2) for default in complying with the provision of this section from 50 rupees to 500 rupees under sub-section (12), making the company and every officer of the company in default liable therefor.

Note: The concept of deemed public company under s. 43A has been abolished by the Companies Amendment Act, 2000. However, consequential amendment in this regard has not been made in sub-section (14).

Companies (Second Amendment) Act, 2002 [11 of 2003]

The powers of Company Law Board under this section have been conferred on the Tribunal constituted under Part 1B of the Act. Consequential changes have accordingly been made in the section. Notes on Clauses of the Bill stated thus:

Notes on Clause.—This clause seeks to amend sections 111, 111A, 113, 117B, 117C and 118 of the Companies Act, 1956 relating to power to refuse registration of transfer of shares or interest of a Member or debentures and appeal against such refusal, rectification of register on transfer, limitation of time for issue of certificates, appointment of debenture trustees and duties of debenture trustees, liability of company to create security and debenture redemption reserve and right to obtain copies of and inspect trust deed. The Company Law Board has been conferred upon certain powers under these sections. It is proposed to confer these powers of the Company Law Board upon the Tribunal. These

amendments are of consequential nature. (*Clause 14 of the Companies (Amendment) Bill, 2001*).

Scope of section

A private company or a deemed public company under s. 43A [s. 43A inoperative w.e.f. 13-12-2000], when it refuses to register a transfer of, or transmission by operation of law of the right to, any shares debentures or interest therein, is required to send notice of refusal to the transferee and the transferor or the person giving intimation of transmission, within 2 months from the date on which the transfer deed or the intimation of transmission is delivered to the company. The company is also required to give reasons for such refusal, *vide* sub-section (1). An aggrieved person, being the transferor or transferee or any other person, may apply to the Company Law Board under sub-section (2) or (4) against refusal, or for rectification of the register of members, if his name is entered in the register without sufficient cause, or for omission of his name from the register or default in making an entry of his name in the register. An appeal under sub-section (2) may be filed within 2 months of the receipt of notice of refusal or within 4 months from the date of lodgment of transfer application in case no notice has been sent by the company. There is no limitation period provided for making an application for rectification of register of members under sub-section (4). For default in registration of transfer within 2 months or for not giving reasons for refusal, as provided in sub-section (1), the offence is punishable under sub-section (12). The Company Law Board is empowered to award damages sustained by the aggrieved party and pass interim orders or injunction or stay regarding payment of dividend, allotment of bonus or rights shares. The Board may decide any question relating to the title of the parties and direct registration of transfers. No petition can be filed in respect of a private company which by its articles has imposed restrictions against the right to transfer its shares [*vide* sub-section (13)]. However, a petition lies under the section in case of refusal by a private company, which is not a subsidiary of a public authority [*vide* sub-section (11)].

Originally, the appellate power was vested with the Central Government and later, the power has been statutorily conferred on the Company Law Board by the Amendment Act of 1988. The CLB can decide any question relating to the title of any person, under sub-section (7); this power was earlier vested with the Court under section 155. Since the Board is now exercising *quasi*-judicial functions, the proceedings are no more confidential as earlier provided in sub-section (3), omitted by the Amendment Act of 1988. Now, the parties cannot claim confidentiality in these proceedings. The CLB was earlier required to give notice to the transferor and the transferee under the then sub-section (5). Sub-section (5) now provides for hearing the parties and the Board is not obliged to issue notice of hearing also to the transferor, unless the petition has been filed by him; the Board is required to give hearing to the company and the aggrieved party, who may be either the transferor or the transferee. The Companies (Appeal to the Central Government) Rules, 1975 earlier prescribed the procedure for filing appeals against refusal. These rules have since been repealed with effect from 31-5-1991, when CLB Regulations, 1991 were notified. The petition under section 111 is required to be filed under the said Regulations.

Under sub-section (6), the Board has been empowered to pass interim orders, including any order of injunction or stay and other interlocutary orders, regarding payment of dividend or allotment of bonus or rights shares during the pendency of the appeal. It may be noted that under section 206A, inserted by the Amendment Act of 1988, provision has been made for transfer of dividend to a special account and for keeping in abeyance any offer of rights shares and any issue of bonus shares, in respect of any instrument of transfer lodged with the company.

Earlier, sub-section (3) which has been omitted by the Amendment Act of 1988, specifically provided that appeal can be filed in case of a public company or a private company which is a subsidiary of a public company. A private company, by its very defini-

tion under section 3(1)(iii) can restrict transfer of its shares. The power of a private company to refuse transfer of shares has been protected by sub-section (13), only to the extent of enforcing restrictions contained in its articles of association. The protection is not available to a private company for refusing transfer of shares on any ground other than the restrictions provided in the articles of association. Now, no distinction has been made as to the right of appeal for refusal for transfer of shares by a private company *simpliciter* and a private company which is subsidiary of a public company. It may be noted that under sub-section (11), petition will lie against non-transmission of shares in, or debentures of, a private company which is *not* a subsidiary of a public company, if such transmission is by way of sale thereof held by a Court or other public authority. Strangely enough, in the aforesaid situation no petition will lie in the case of a private company which is a subsidiary of a public company, which perhaps was not the intention of the legislature. To sum up, appeal under sub-section (2) and application under sub-section (4) against refusal to transfer share lies:

(a) against a public company under S. 43A; [*since omitted]*

(b) against a private company which is not a subsidiary of a public company, for non-transmission of shares as a result of Court sale, under sub-section (11);

(c) against a private company (whether it is a subsidiary of a public company or not) on any ground not stated in restriction contained in its articles of association [See sub-section (13)].

For purposes of this section a deemed public company under section 43A was held to stand on the same footing as a private company since it retained the provisions of section 3(1)(iii) to the extent it related to restrictions contained in its articles of association as to transfer of shares. Accordingly, no appeal was allowed where transfer was rejected in accordance with the company's articles. *Mohd. Erfan Randharian v. Randharian and Singh P. Ltd.,* (CLB Appeal No. 10/80, dated 2-11-1981). Section 111 will not apply to a deemed public company which retains in its articles, the characteristics of a private company. *Kodali Sree Rama Nagendra Venkata Subba Rao (Dr.) v. Sri Ramdas Motor Transport Ltd.,* (1983) 2 Comp LJ 64 (CLB). [Section 43A inoperative]

The application for rectification of register of members can be filed by an aggrieved person on any of the circumstances stated in sub-section (4).

By virtue of sub-section (14) inserted by the Depositories Act, 1995 (w.e.f. 20-9-1995), the provisions of the section are applicable only to private companies.

In reference to the scope of the powers of the Company Law Board under the section, it has been held that the CLB cannot adjudicate upon issues like appointment of directors, or resignation by them, or the alleged manipulation of the resignation of one of the promoter-directors, or the validity of a memorandum of understanding which some of the members might have entered into. *G. Venkitapathy v. Prakathi Spinners P. Ltd.,* (2002) 49 CLA 97 : (2002) 38 SCL 131 : 2002 CLC 1529 (CLB).

Noteworthy points in the section

Briefly stated, the provisions of this section apply to the registration of both transfer and transmission, by operation of law, of the shares and debentures in a company. The following points may be noted:

(1) An application for the registration of a transfer of shares in a company may be made either by the transferor or by the transferee (S. 110).

(2) The transfer application may, where there is no certificate in existence, be delivered along with the letter of allotment enclosed with it (S. 108).

(3) A transfer executed by the legal representative of a deceased member is as valid as executed by the member himself (S. 109).

(4) In the case of partly-paid shares, the transfer shall not be registered unless notice by registered post is given to the transferee and he does not object for two weeks (S. 110).

(5) If a company refuses to register the transfer of, or the transmission by operation of law of the right to, any shares or debentures of, the company, it shall within two months of the lodgement of the instrument of transfer, or intimation of such transmission, send notice of the refusal, giving reasons for such refusal.

(6) In case of refusal, or failure or undue delay, to register a transfer or transmission by a company an appeal lies to the Company Law Board and the Board will by order in writing either direct the registration of the transfer or transmission or confirm the refusal and in the former case, may direct the company to pay damages to the party aggrieved.

(7) Apart from the right of appeal against refusal of transfer or transmission of shares, the aggrieved party may, by making an application, move the Company Law Board for rectification of register of members. The Board may also decide any disputed question of title during the course of proceedings for rectification of register of members.

(8) While adjudicating a matter relating to transfer or transmission of shares, or debentures, or otherwise involving rectification of register of members of a company, the Company Law Board is empowered to pass interim orders, including grant of injunction or stay, incidental or consequential orders regarding payment of dividend and allotment of bonus or rights shares, and award of costs.

(9) Private companies are free to enforce the restrictions as may be contained in the articles of association against the right to transfer their shares. [Sub-section (13)].

Grounds on which listed company could refuse to register transfer

The grounds on which public listed Companies could refuse to register transfer were to be found in S. 22-A of SCR Act, 1956. This section has been omitted from the SCR Act, 1956 by the Depositories Act, 1996. The result is that no ground is available to a public company, listed or unlisted, for refusing a transfer. Section 111A brought in by the same Act, applicable in case of a public company listed or not, emphatically says in sub-section (2) that the shares of a public company shall be freely transferable. The only ground on which a public company may refuse a transfer is on some "sufficient cause" and this expression is confined only to three situations, namely, violation of SEBI Act, or Regulations, SICA or any other law in force. See *Gujarat Machinery Manufacturers Ltd. v. Nile Ltd.*, (2001) 105 Com Cas 817 (CLB).

§ As per proviso to section 111A(2), appeal lies against refusal to transfer shares. See Notes under S. 111A.

Important Note.—The commentary and case laws with reference to s. 22-A of SCR Act, 1956 [*Since Omitted w.e.f. 20-9-1999*] is given for guidance.

SCR Act not applicable to non-listed companies.—A single Judge of the Calcutta High Court in *B.K. Holdings (P.) Ltd. v. Premchand*, (1983) 53 Com Cases 367 (Cal) and a Division Bench of the same High Court in *East Indian Produce Ltd. v. Naresh Acharya Bhaduri*, (1988) 64 Com Cases 259 (Cal) were of the view that the Securities Contracts (Regulation) Act, 1956 does not govern the transactions for transfer of shares of a private company. A Division Bench of the Bombay High Court in *Dahiben Umedbhai Patel v. Norman J. Hamilton*, (1985) 57 Com Cases 700 (Bom) held that the Act was intended to govern transactions in the market, *i.e.*, stock exchange and not intended to apply to transfer of shares of a private company, if such transfer was by way of a private transaction. In a later decision in *Brooke Bond India Ltd. v. U.B. Ltd.*, (1994) 79 Com Cases 346 (Bom) a single Judge of the Bombay High Court observed that the Judges of Bombay High Court made observations which, though made in connection with transactions by private treaty of shares of a private limited company, were equally applicable to similar transactions of shares of a public limited company which is not listed at the stock exchange. In coming to this conclusion, the learned Judge claimed to differ from the view of the Calcutta High Court in the two cases referred to above.

Function and role of CLB in considering reference.—The function and role of CLB in considering a reference under section 22A of the Securities Contracts (Regulation) Act, 1956 [*Since Omitted*] was

considered in *Gammon India Ltd. v. Hongkong Bank (Agency) P. Ltd.*, (1992) 74 Com Cases 123 (CLB). The reference was by reason of the directors' refusal to accept certain transfers because that would involve a change in the composition of the Board of directors in a manner which would be prejudicial to the interests of the company. On facts the CLB refused to interfere because the greater number of transfers appeared to be a part of the conspiracy to destabilise the company. The CLB said that it does not sit in judgment to compare the merits and demerits of the management of the board of directors which rejected the transfers with those of the new likely changed board of directors and decide which is good or bad. The Board has to see whether the material placed before the directors at the material time was such as to enable them to form an opinion in good faith that there is likelihood of a change in the composition of the board of directors and if so whether such a change would be prejudicial to the interest of the company or public interest. While, in the case of orders under section 250(3), the opinion is formed by the Company Law Board, in the case of a reference under section 22A [*Since Omitted*], the Company Law Board only confirms or rejects the opinion formed by the directors. Secondly, in the former case, the change in the composition of the board should be such as would be prejudicial to the public interest while, in the latter case, the change should be such as would be prejudicial to the interest of the company or to the public interest. In a case under section 247/250 of the Companies Act, not only the material available to the board of directors is considered but the facts revealed in the investigation and at the hearing are also considered by the CLB. In a reference under secion 22A of the SCRA [*Since Omitted*], one has to consider only the material that was available to the directors while considering the request for registration of transfer of shares. The CLB did not interfere in the judgment of businessmen which was supported by a consideration of the facts. In the matter of transferees of a minor nature who were not linked with the main transferee, the CLB ordered the transfers to be registered. The CLB also pointed out that since it has to examine the justification of the directors' opinion on the basis of facts available to them at the time when they sat to decide the matter, no further opportunity could be given to the transferees to bring on record some subsequent events so as to establish that the refusal was *mala fide* and with an ulterior object.

In another pronouncements on the subject in the same year the CLB made this shift in its stand that though generally it will confine itself to the grounds which came before the company's Board of Directors at the time of refusal, the CLB shall be at liberty to take cognizance of any other illegality of fact which did not come before the company's Board because only then the CLB will be able to render proper justice as an arbitrator. The CLB cannot afford to overlook facts which though not before the company's Board are very much relevant to the ground taken up by the company. In this case the shares in question had all been acquired by the Rasoi group as a whole and the consideration was also provided by them. It was this factor in the context of many other factors which influenced the CLB to uphold refusal by the company's Board of Directors. Such factors were listed by *Chakraborti Member* at p. 393: "there was a likelihood of change in the composition of the Board of Directors because of the rising proportion of shareholding of Rasoi group; innumerable litigation with regard to the holding and conduct of general meeting of the company particularly, relating to appointment of directors; urge on the part of the Rasoi group to acquire huge blocks of shares, participate in the management and attempts to destabilise the management; the shareholding of various litigants and further acquisitions by others who had links with the Rasoi group; the mechanism of acquiring shares without lodging the documents for registration without any valid reason; the highly volatile fluctuations in market value of the shares compared to the intrinsic value; the depleting nature of the public shareholding consequent to the acquisition; confining the investment by Rasoi only to the petitioner company's shares. The likelihood of change does not require 51% holding. Any acquisition or indirect control matching with the holding of Molins could tilt the balance of power. With the acquisition spree by Rasoi group from 7.5% in 1982 to controlling 25.3% in 1991, and with the allegation of further acquisitions, the likelihood of change in management very much existed. In view of these factors, there was a positive conclusion that a change was likely to result in the composition of the Board of Directors."

The CLB further noted that there were violations of sections 372 and 292 of the Companies Act but that such violations do not give any ground to the company to refuse to accept the transfer. The CLB was in conclusion of the view that any group of shareholder taking over the management to further the interest of the company should be welcome but in the circumstances of the present case no such evidence was shown to exist. *MOI Engineering Ltd. v. Foster Consultants Ltd.*, (1996) 3 Comp LJ 367 (CLB).

It has been held that though a reference under s. 22-A of SCRA [*Since Omitted*] is not in the nature of an appeal the role of CLB is similar to that of an arbitrator keeping in view the overwhelming twin objectives, namely, free transferability of securities and adequate protection of companies from hostile takeovers and therefore the role under s. 111 of the Companies Act becomes different because there the CLB is an appellate authority. *MOI Engineering Ltd. v. Foster Consultants and Investments (P.) Ltd.*, (1996) 3 Comp LJ 367 (CLB); *Foster Consultants and Investments (P.) Ltd. v. MOI Engineering Ltd.*, (1996) 3 Comp LJ 367 (CLB).

Where the Board of directors of the company in question had already been reconstituted under section 409 and the resolution of the Board of directors in refusing a transfer did not point out to any materials

that any change in the composition of the Board of directors would be prejudicial to the company's or public interest, the opinion of the directors was not confirmed. *Patel Engg. Co. Ltd. v. Patel Relators P. Ltd.*, (1992) 74 Com Cases 395 (CLB).

The Company Law Board was directed in *Vasant Investment Coprn. Ltd. v. CLB*, (1999) 33 CLA 265 (Bom) to consider the matter afresh where without examining the motive behind acquisition of shares it had accepted the directors' version that the transfer in question would bring about a change in the composition of the board of directors.

Likelihood of change in Board composition [S. 22A of SCR Act, 1956]*.—"Likelihood" does not mean a situation of certainty. The word refers to a chance which may or may not happen. Acting on this in *Gordon Woodroffe Ltd. v. Trident Investment and Portfolio Services P. Ltd.*, (1994) 79 Com Cases 764 (CLB—Mad), the CLB held that where there is an intention to gain control and a further acquisition of shares by one group and it considerably narrows the margin in terms of control, then the threat is real and apparent. The number of shares of which the transfer was demanded and refused by the company's board constituted 6.84% of the paid-up capital of the company. The directors' apprehension of a change in the composition of the board by reason of such massive purchase was held to be fully justified and also that such change would prejudically affected the company.

The Supreme Court in its decision in *Bajaj Auto Ltd; Bajaj Auto Holdings Ltd. v. Company Law Board*, (1999) 95 Com Cases 12 : (1998) 3 Comp LJ 366 : (1998) 30 CLA 195 (SC) has emphasised that directors must exercise their power of refusing transfer of shares in goodfaith in the interest of the company. It is not a ground by itself that the transferee entertains the intention of increasing his shareholding. There must be proof of the fact that behind the acquisition of shares there was the oblique motive of destablising the established management. If the contention is that the intention behind acquisition of shares was to make two companies become inter-connected with each other, this aspect should be examined on the basis of shares presently acquired and applied for registration and not on the basis of some conjectured future acquisitions.

Where the transferee was already having 22% of shareholding and the shares under transfer, which was refused by the company, amounted to only 1% whereas the controlling block along with its foreign collaborator commanded 42% holding, it was held that the transfer in question was not likely to bring about a change in the composition of the company's Board of directors and, therefore, the refusal was not justified. *Bajaj Tempo Ltd. v. Bajaj Auto Ltd.*, (1994) 80 Com Cases 618 (CLB). The CLB added that the purpose of S. 22A of the Securities Contracts (Regulation) Act, 1956 [*Since Omitted*] was not confined to protecting only small investors.

A sale of 50 or 100 shares of two companies to two other persons belonging to a group competing with the company was held to be too insignificant a thing to bring about any prejudicial change in the composition of the Board. *Kinetic Engg. Ltd. v. Bajaj Auto Holdings Ltd.*, (1995) 4 Comp LJ 549 (CLB).

Acquisition of 4.86% shares by three subsidiaries of another company was held to be not sufficient in itself any prejudicial change in the composition of the Board of directors. The CLB was also influenced by the fact that about 1/3rd capital of the company was held by financial institutions who therefore had a substantial say in the matters of the management of the company's affairs. *Carbon Corporation Ltd. v. Ceat Investments Ltd.*, (1992) 8 Corpt LA 95 (CLB).

Where the hostile block of shareholders were already holding over 14% shares and had applied for the transfer of over 15% shares of the company's paid-up capital, it was held that the directors' apprehension that this would bring about a prejudicial change in the composition of the Board was justified. *Pooma Industries Hotel v. Shivmohan Mukkar*, (1991) 6 Corpt LA 116 (CLB).

Where financial institutions were holding more than 73% of the company's equity, a refusal to register the purchase of 5.34% by four private companies was held to be not justified, but because there was an apprehension that the group to which the private companies belonged might make a take-over bid, the CLB ordered that the financial institutions and Government Companies should not part with their shareholdings to anyone else without making reference to CLB. *Dunlop Investments P. Ltd. v. Vikrant Tyres Ltd.*, (1995) 4 Comp LJ 557 (CLB).

A company was not allowed to refuse a transfer of shares where the acquisition amounted to only two per cent of the company's issued capital and it could not be said that it would bring about a change in the management of the company. Apart from this, there was no evidence to show that the acquisition was a *benami* transaction. *Bharat Strips Ltd. v. Mayur Mangaldas Kothari*, (1997) 2 Comp LJ 252 : (1998) 92 Com Cases 815 : (1997) 25 CLA 96 (CLB—SB).

A person was already a shareholder to the extent of 9.68% and was working as joint managing director. He purchased further shares to the extent of 3.81% and applied for registration. He was refused. The Company Law Board did not uphold the refusal. In the opinion of the Board, 13% shareholding would

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* Since Omitted w.e.f. 20-9-1995.

not have brought about any such change in the composition of the company's Board of Directors as would have prejudiced the company or public interest. There were three shareholder blocks and the other two were holding 70%. *Vimal K. Gupta v. Auto Lamps Ltd.*, (1996) 86 Com Cases 157 (CLB—NR).

Section 22A was omitted under an amendment with effect from Sept. 20, 1995. One of the provisions enabled a company to refuse a transfer of shares if the transfer was likely to result in change in composition of the board of directors, which would go against the interest of the company or public interest. In a cause belonging to the period prior to the amendment it had been held that acquisition of 8.84% shares by a group of members already holding 14.7% was not likely to change the complexion of the board of directors in a manner prejudicial to the company's or public interest *Canara Land Investment Ltd. v. Sea Rock Investments Ltd.*, (1999) 35 CLA 209 : (1999) 22 SCL 377 (CLB–SB).

Burden on company to justify refusal.—Where the company failed to place before the Company Law Board any material to justify their apprehension that prejudicial changes would be brought about in the composition of the company's board of Directors, the company's rejection of the share transfer was held to be not justified. *Surat Electricity Co. Ltd. v. Union of India*, AIR 1995 Bom 377; *Texmaco Ltd., Re*, (1996) 1 Comp LJ 154 (CLB—EB).

Grounds on which CLB to decide validity of refusal.—Where the refusal by a company to register a transfer of shares is brought before the CLB under an appeal, the grounds available to the Board of directors at the time of refusal would also constitute the grounds on which the CLB should proceed to decide the matter. The CLB need not go into the grounds which were not put before the company but were put before the CLB in appeal. *Vikas Jalan v. Hyderabad Industries Ltd.*, (1997) 88 Com Cases 551 (CLB—SB).

When listed company bound to refer refusal to CLB.—Under section 22A(4) of the Securities Contracts (Regulation) Act, 1956, [*Since Omitted*] in case a listed company refuses to accept a transfer of shares on the ground stated in sub-s. 3(a), namely, that the instrument of transfer has not been duly executed and stamped or the law relating to registration of transfer has not been complied with, it is only required to intimate the transferor and transferee, about the grounds of refusal and reference to Company Law Board is not necessary. In such cases, appeal against refusal lies with the Company Law Board under section 111(2). In case, however, the listed company refuses transfer of shares on any other ground, namely, that the transfer is in contravention of law or it will change the composition of Board of directors prejudicial to the interest of the company or to public interest or the transfer is prohibited by an order of a Court or Tribunal, it is mandatory on the part of the company to make a reference to the Company Law Board, before refusal. In such cases, the question of filing a petition under section 111 does not arise as the aggrieved transferor and transferee automatically become parties to the reference proceedings before the CLB.

Transfers in violation of law.—The word "law" in S. 22A of the Securities Contracts (Regulation) Act, 1956 [*Since Omitted*] means the law for the time being in force in India and not merely the Companies Act. *Gordon Woodroff P. Ltd. v. Trident Investment and Portfolio Services P. Ltd.*, (1994) 79 Com Cases 764 (CLB—Mad). Accordingly, any violation of the Benami Transactions Prohibition Act, 1988 can be taken into account. In another decision, namely, *Kothari Industries Corpn. Ltd. v. Lazor Detergents P. Ltd.*, (1994) 81 Com Cases 617 (CLB), the Company Law Board held that once there is a statutory violation (instrument of transfer not properly stamped in this case), the transfer would be ruled out even when it has already been registered by the company. On appeal the Madras High Court held that where the only defect is non-cancellation of stamps, it would be only an irregularity and not illegality and the company having registered the transfer, it should not be allowed to rectify the register after it has lost the time available for seeking rectification. *Kothari Industries Corpn. v. Lazor Detergents P. Ltd.*, (1994) 81 Com Cases 669 (Mad). **Affirmed** in *Kothari Industrial Corporation Ltd. v. Lazor Detergents P. Ltd.*, (1994) 81 Com Cases 699 (Mad—DB).

Where the shares of a member were attached under a court order under the Civil Procedure Code, the registration of any transfer of such shares by the company while the attachment was in force was held to be void because it was in violation of a court order. *Mannalal Khetan v. Kedar Nath Khetan*, (1977) 47 Com Cases 185 : AIR 1977 SC 536.

Judicial review of CLB decisions.—A person affected by and aggrieved of a decision of the CLB may seek review even if he was not a party to the original reference arising out of the matter of the refusal by a listed company to register a transfer. Seventy three per cent shareholding of the listed company in this case was held by public financial institutions and nationalised banks. A group of companies purchased 5% of the company's equity from financial institutions and applied for transfer. The company refused to accept the transfer and referred the matter to the CLB for approval. The CLB directed the registration of the transfer but placed restrictions on the financial institutions in disposing of their shares. These institutions sought a review of the order. There was some delay in filing the review petition. The CLB exercising its power to enlarge time condoned the delay and accepted the petition. The review petition was held to be maintainable because the financial institutions were an aggrieved party though they were not a party to the original reference. They were heard through their nominee directors on the company's Board of directors and, therefore, there was no denial of natural justice to them. The Central Government issued guidelines to the institutions in the matter of disposing of more than 10% of their holding

in a company. For any other kind of disposal the CLB modified its order and allowed certain percentages to be transferred in small bits through approved brokers. *Industrial Development Bank of India v. Dunlop Investments P. Ltd.*, (1992) 74 Com Cases 64 (CLB).

***Independent jurisdiction of CLB under s. 22A* of SCR Act.**—The Company Law Board expressed the opinion that the jurisdiction conferred on it under section 22A of the Securities Contracts (Regulation) Act, 1956 [*Since Omitted*] is quite distinct and independent of the jurisdiction vested in the CLB in respect of the provisions of section 409, 247/250, 155, [now s. 111] *etc.* of the Companies Act, 1956. The Board held that section 22A [*Since Omitted*] does not confer a power on the company's Board of directors of the type mentioned in clause (c) in sub-section (3). In the absence of any such power in the company's articles the directors would not have the power to refuse on that ground. The Board further said that even if it could be assumed for the sake of argument that a company could have refused to register a transfer notwithstanding the fact that such power does not appear in the company's articles, the onus will still be on the company to prove that the type of effects stated in section 22A [*Since Omitted*] would be there if the transfer were accepted. On the facts the company was not able to prove any such effect and therefore CLB ordered it to register the transfer. Though the High Court had directed the transferors not to do anything in reference to shares under transfer, there was no stay order against the Company Law Board. *Sinclairs Hotels and Transportations Ltd. v. Pressman Advisory Services Ltd.*, (1989) 2 Comp LJ 49 (CLB).

It is not the requirement of law to state all facts and circumstances on which the opinion was formed in the resolution of the Board of Directors so long as, in compliance with the provision of sub-s. (6), all such materials on which opinion was formed were placed before the CLB. *Bajaj Tempo Ltd. v. Unit Trust of India*, (1992) 73 Com Cases 451 (CLB).

Section 22A(4)* of Securities Contracts (Regulation) Act mandatory : Period within which company should act.—Under this section, a company shall before expiry of two months from the date of lodgement, not only form in good faith its opinion as to whether registration ought or ought not to be refused but also register the transfer in case it forms an opinion in favour of registration or make a reference to the Company Law Board in case of refusal and forward copies of each reference to transferor and transferee if it formed an opinion to refuse registration on the grounds mentioned in clauses (b), (c) and (d) of sub-section (3). Thus, a company is required to do all the three things, namely, form an opinion, file a reference with Company Law Board and send notices to the transferor and transferee within a period of two months from the date of lodgement. The Company Law Board has in its various decisions under s 22A held that these requirements are mandatory and failure to comply with them will result in treating the reference as non-maintainable. *Patel Engineering Co. Ltd v. B.Y. Investments Pvt. Ltd., etc., (Ref. Nos.* 12 to 20/SC/CLB/WR/91 decided by CLB on 28-7-1992).

Duty to return documents.—A listed company has to exercise its option to refuse or to accept a transfer within the time limits set by section 22A of the Securities Contracts (Regulation) Act, 1956 [*Since Omitted*]. In case the company is not able to come to any conclusion because of lack of information from the transferee, the documents must be returned to the person who lodged them. They cannot be retained beyond the prescribed time limit. That would be a statutory violation. Where there is no evidence or record with the company on the matter, it cannot brand the transaction of transfer as contrary to public policy. *AV Sampat, OL, BOB Fiscal Services P. Ltd. v. Dunlop India Ltd.*, (1996) 87 Com Cases 398 (CLB—Cal).

Section 22A(5)* of Securities Contracts (Regulation) Act not mandatory.—The requirement laid down in sub-section (5) is directory in character. Although the requirements of sub-section (5) are procedural in nature, it does not mean that whenever a requirement of statute is directory the same could be dispensed with. Even non-compliance of procedural requirements may be mandatory in character but whether or not that is so would have to be ascertained from the intent and purpose of the statute and the provisions made therein. Where the consequence of non-compliance of a procedural requirement is dismissal of a petition, which itself is provided by the statute, the procedural requirement itself has to be construed as mandatory. In the instant case, the petitioner had made substantial compliance by offering to produce the instruments of transfer and share certificates as soon as called upon to do so. *Taxmaco Ltd., Re*, (1991) 5 Corpt LA 353 (CLB).

Transfer in respect of pledged shares

In respect of transactions where the pledged shares are involved, the title passes as soon as the pledger hands over the security and gives the blank transfer form and, therefore, such transactions are not in violation of Section 13 of the SCR Act. Number of financial institutions accept pledge of shares in blank transfer forms and if the pledger fails to pay the liabilities the blank transfer forms are completed and lodged for transfer. If

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* Since *Omitted* w.e.f. 20-9-1995.

such transactions are considered as void according to the provisions of Sections 13 and 18 of the Securities Contracts Regulation Act it will create innumerable difficulties and will negate the existing commercial practices prevailing in the market. *Jagdish Chandra Champaklal Parekh v. Deccan Paper Mills Co. Ltd.,* (1994) 80 Com Cases 159 (CLB). **Dissenting** from this view, it has been held in *A.K. Menon v. Fairgrowth Financial Services Ltd.,* (1994) 81 Com Cases 508 (Special Court—Bombay) tagged with *B.O.I. Finance Ltd. v. Custodian,* (1994) 81 Com Cases 508 (Special Court—Bombay) that a mere receipt of share certificates along with blank transfer forms by way of pledge does not give to the pledgee any right, title or interest in the shares at the time of the pledge. He gets no rights till he gets the rights to enforce the security on default by the pledger. The Court **followed** its own decision in *Hindustan Dorr Oliver Ltd. v. A.K. Menon,* (1994) 80 Com Cases 384 (Special Court—Bombay). However, the Special Court was considering the meaning of the word security for the purposes of the Special Court (Trial of offences relating to transaction in Securities) Act, 1992.

The order of the Special Court in *BOI Finance Ltd. v. Custodian,* (*Supra*) was **set aside** by the Supreme Court in *BOI Finance v. Custodian,* (1997) 4 Comp LJ 134 at p. 159 (SC) : AIR 1997 SC 52 : (1997) 89 Com Cas 74 : (1997) 25 CLA 115 KIRPAL J concluded as follows :

> The validity of the transfer of the securities has to depend on the provisions of the Transfer of Property Act and the Sale of Goods Act relating to transfer and not to the validity of the agreement preceding the transfer. Like any other movable property the securities could validly be purchased on delivery against payment of price as per sections 4, 19 and 20 of the Sale of Goods Act. The price paid, while taking delivery, was the consideration for the transfer of the securities. When the transfer of title has taken place, the agreement between the parties preceding this cannot invalidate the transfer. The ratio of the decisions in *Sajan Singh v. Sardara Ali,* (1960) 1 All ER 269 : (1960) AC 167 and *Tinsley v. Milligan* (1993) 3 All ER 65 (HL) and the observations of RAJAGOPAL AYYANGAR J. in *Surasaibalini Debi v. Phanindra Mohan Majumdar,* (1965) 1 SCR 860 : AIR 1965 SC 1864 are clearly applicable in the present case. Inasmuch as the aforesaid reasons are sufficient for the appeals to be allowed, we do not propose to deal with the other contentions which had been raised on behalf of the appellants.
>
> **"Conclusions**
>
> The following conclusions from the aforesaid discussion :
>
> (A) Infringements of the instructions issued by the Reserve Bank of India under the Banking Regulation Act prohibiting the banks from entering into buy-back arrangements do not invalidate such contracts entered into between the banks and its customers.
>
> (B) The ready forward contract is severable into two parts, namely, the ready leg and the forward leg. The ready leg of the transaction having been completed, the forward leg, which alone is illegal, has to be ignored.
>
> (C) With the ready leg having been performed, the illegality of the forward leg contained in the agreements cannot affect the transfers which had already taken place.
>
> The appeals are accordingly allowed. Judgement dated 14 December, 1993, of the Special Court is set aside, the effect of which would be that the applications filed by the Custodian and the notified persons for the return of the securities stand dismissed. There will be no order as to costs."

Where certain shares were pledged under blank transfer forms and the pledgee applied for registration of the transfer on default by the pledger to pay back the pledge money, the Company Law Board did not approve the refusal by the company and directed registration of the transfer. This was held to be not a decision on merits about the entitlement to the shares and, therefore, it did not have the effect of *res judicata* on the question of title. *Jagdishchandra Champaklal Parekh v. Kantilal Prabhudas Mehta,* (1995) 18 Corpt LA 144 (Bom).

Delay on the part of company.—Where a company delayed reference to the CLB for refusing a transfer, did not make the application in the prescribed format and neither made an application for condonation of delay nor disclosed the grounds of refusal, the CLB ordered the company to register the transfer within 10 days from the date of the receipt of the order and file a compliance report within a week's time thereafter, *Diamant Carbon and Graphite Products Ltd. v. Paresh J. Shah,* (1992) 1 Comp LJ 194 (CLB).

Change in management under court order.—Where the change in the management had already taken place by virtue of an order of the High Court under s. 409, and since the resolution of the Board of directors refusing the transfer did not show how the change would be prejudicial to the interests of the company or the public interest, the court did not accept the opinion of the Board of directors. *Patel Engg. Co. Ltd. v. Patel Realtors P. Ltd.*, (1992) 74 Com Cases 395 (CLB).

Prejudicial to company's or public interest.—See under this section under the heading "Functions and role of CLB in considering reference" *ante.*

CLB Power in respect of transfer of shares in Banking Companies

There were 122 transferees but the shares under transfer amounted to only 3.16 per cent of the banking company's paid-up capital. All the transferees were connected with one industrial group. The company refused to register the transfers saying that such a block transfer would cause prejudicial change in the directorship of the company and also that there was violation of RBI directions. The Company Law Board held that percentage of the shares involved was too small to cause prejudicial changes because there was the public holding of 51%. There was no statutory violation if RBI approval was taken. The Board was of the view that it had no jurisdiction over transfers of banking company's shares. It could not direct registration of the shares in question. The company was advised to make a fresh reference to the Reserve Bank. *Bank of Madura Ltd. v. M.O. Bhaskaran,* (1995) 83 Com Cases 321 (CLB—SR). This decision was **followed** in *Hemangini Leasing P. Ltd. v. Tamilnad Bank,* (1996) 86 Com Cases 875 (CLB). In this case, shares of a banking company to the extent of 60% were purchased by a group of companies in a transaction which looked like a friendly takeover. It was held that the transaction was not illegal or in violation of RBI regulations. The company has only to seek acknowledgment from RBI before registering the transfer.

Where the petitioner purchased only an insignificant number of shares of a banking company and the company asked him questions about his income tax matters and sources of finance, it was held that since the RBI Guidelines applied only when the purchase of shares was intended to acquire controlling interest, the bank was wrong in asking the questions. It was bound to accept the transfer. *T.S. Premkumar v. Tamilnad Mercantile Bank Ltd.*, (2001) 33 SCL 802 : (2001) 44 CLA 259 (CLB—Chennai).

Shareholding and Transfer of shares of Banking Companies : RBI Circulars

I. Reserve Bank of India Circulars.—As far as the provisions of RBI circulars are concerned, RBI issued 3 circulars as per the powers conferred on it by section 35A of the Banking Companies Regulation Act—one in 1970 and another in 1991 and the last on 16-4-1994. The circulars are reproduced below:

Circular, dated 13-1-1970.—"It has been decided that as and when your bank receives an application for transfer of shares which would make the holding of the proposed transferee equivalent to 1% and over of the total paid-up capital of the bank, you should within three days of such lodgement, advise our regional office concerned, the full particulars of the proposed transfer, such as name, address and occupation of the transferee, number of shares, paid-up value of shares and percentage to the total paid-up capital, consideration *etc.* and if possible, purpose of investment. A declaration to the effect that the proposed transferee is not likely to acquire singly or along with the companies and concerns in the group a controlling interest in the bank should also be furnished to the Reserve Bank. If, on the other hand, on the basis of information available with the bank, the transfer of shares appears to be not in the nature of genuine investment by the transferee concerned or if the bank suspects any attempt at cornering of shares with a view to acquiring a controlling interest in the bank it should forthwith report the matter to the Reserve Bank.

2. The bank should await an acknowledgment from us before effecting the above transfers."

II. Circular, dated 23-5-1991.—"Please refer to our Circular DBOD No. EFS 93/C.249-70, dated January 13, 1970 [*printed above*] requiring banks to obtain an acknowledgment from Reserve Bank of India before effecting transfer of shares when the transfer makes the shareholdings of the individual/group equivalent to 1% and over of the total paid-up capital of the bank. The primary purpose of our instructions in this regard was to put the banks on guard against attempts by individuals/groups to acquire

a controlling interest in a bank by manipulating acquisition of shares and the consequential adverse influence on the functioning of the bank.

2. We have, however, recently come across some instances where banks have overlooked our instructions and have had to face problems following cornering of shares by a few individuals/groups. This could have a destabilising effect on the working of the banks.

3. We, therefore, have to reiterate our instructions that when on the basis of information available with the bank, any transfer of shares appears to be not in the nature of genuine investment or if the bank suspects any attempt at cornering of shares with a view to acquiring controlling interest in the bank, the bank should take appropriate action. When the transfer of shares makes the holding of the proposed transferee, either singly or along with companies/concerns in the group equivalent to 1% and over of the total paid-up capital of the bank, the matter should be referred to the Reserve Bank of India, within three days of the lodgement of shares and the bank should await an acknowledgment from us before effecting the transfer. More importantly, banks should in their own interest anticipate such situation whenever they make rights issues and take all necessary measures to ensure that no individual or groups manoeuvere to corner large blocks of shares."

III. Acquisition of shares of banks for gaining controlling interest

Circular, dated 16-4-1994.—"Please refer to our Circulars DBOD No. EFS 93/C.249-70, dated January 13, 1970 and DBOD Fol. BC. 129/C.249-91, dated May 23, 1991 [*both printed above*] requiring banks to obtain an acknowledgment from Reserve Bank of India before effecting transfer of shares when the transfer makes a shareholding of the individual/group equivalent to one per cent and over of the total paid-up capital of the bank. We observe that the primary purpose and the procedure set out in our circulars have not been appreciated judging by the enquiries received by us.

2. The instructions issued by the Reserve Bank regarding transfer/allotment of shares which would take the shareholding of the transferee either singly or along with the associated individuals, companies and concerns in a group to one per cent or over of the total paid-up capital are basically to alert the board of directors of the bank regarding manipulation in acquisition of shares to gain controlling interest in a bank and the likely consequential adverse influence in destabilising the working of the bank. Blocks of shares could be acquired either at the time of right issues by way of renounced shares by offering huge monetary incentives to the renouncers, or by purchasing shares from individual shareholders privately by offering to them an abnormally high price not warranted by the financial indicators of the bank. Even the prices of quoted shares have been artificially boosted by active trading for this purpose. At times, RBI instructions have also been sought to be by passed by applying for individuals allotment/transfer of less than one per cent of the paid-up capital in an organised manner. The obvious intention of the concerted efforts of the interested group or an industrial house is to corner the bank's shares by every available means. The transfer/allotment of shares is often not in the nature of a genuine investment.

3. We have, therefore, to clarify that a reference to Reserve Bank will be necessary even when individual allotment/transfer of shares is for less than one per cent of the paid-up capital of the bank if the above dubious method has been adopted to get over the ceiling of one per cent and to camouflage the purpose of cornering of shares by individuals/groups.

4. It is necessary that the management of a bank should be vigilant about any move made through the backdoor by individuals/groups to corner shares of the bank. The Board should deliberate on all aspects of allotment/transfer of shares and take a view after due consideration of all aspects, including the credibility of the persons or entities acquiring the shares where the acquisitions are for significant amounts. The Board should in particular consider whether our instructions to pre-empt hostile takeover of banks by individuals/groups have been scrupulously followed. The bank should approach the Reserve Bank of India with all the relevant details for acknowledgment of transfer/allotment of shares after the Board makes such a review. It is also reiterated that banks Boards should invariably await the Reserve Bank's acknowledgment, for approving the registration of the transfers in their books".

Comments on Circulars.—A combined reading of these circulars would show, that, in case of acquisition of shares equivalent to and over one per cent the total paid-up capital of the bank, the bank should make a reference to RBI within three days of the lodgement and the Bank should await an acknowledgment from RBI before effecting the transfer of shares. The intention as is obvious from the contents of the circulars, is that, the controlling interest in the Bank is not passed on without the knowledge and approval of RBI. However, there is nothing in these circulars to indicate that no one should acquire shares beyond 1 per cent. Thus, refusal on the plea of violation of RBI Circulars cannot be sustained.

Guidelines for operation in Securities by Banks

Press Release, dated May, 1992.—The Reserve Bank of India issued instructions to banks in July, 1991 concerning transactions in securities held by banks in their investment portfolios, following a scrutiny of such transactions undertaken by it in some banks. These instructions which were of a detailed nature, were intended to ensure that transactions in securities by banks were conducted in an orderly manner.

Banks were enjoined to frame and implement a suitable investment policy to ensure that operations in securities are conducted in accordance with sound and acceptable business practices. While evolving the policy, they were required to keep in view the following guidelines.

(i) "Under no circumstances, the bank should hold an oversold position in any security, that is to say, that no sale transactions should be put through without actually holding the security in its investment account.

(ii) All the transactions put through by bank either on an outright basis or ready forward basis and whether through the mechanism of SGL Account or bank receipt should be reflected on the same day in its investment account, and accordingly, for SLR purpose, wherever applicable.

(iii) Transactions between one bank and another bank should not be put through the brokers' account. The brokerage on the deal payable to the broker, if any, (if the deal is put through with the help of a broker) should be clearly indicated on the notes/memorandum put up to the top management seeking approval for putting through the transaction and separate account of brokerage paid broker-wise should be maintained.

(iv) For issue of BRs, the banks should adopt the format prescribed by the IBA and should strictly follow the guidelines prescribed by them in this regard subject to the above, the banks should not issue BRs covering their own sale transactions only and should not issue BRs on behalf of their constituents including brokers.

(v) The banks should be circumspect while acting as agents of their broker clients for carrying out transactions in securities on behalf of brokers.

(vi) Any instance of return of SGL Form from the Public Debt Office of the Reserve Bank for want of sufficient balance in the account, should be immediately brought to the Reserve Bank's notice with the details of the transactions".

A copy of the policy framework for undertaking transactions in securities approved by the bank's Board was to be forwarded to the Reserve Bank (*Source* : Credit Information Review, May, 1992).

SEBI Regulations and Government guidelines not applicable to UTI

Mutual fund companies have been restricted by SEBI regulations and Government guidelines to confining their investments in other companies to certain percentages, namely 5% of the investee company's paid up share capital. On the other hand, the Unit Trust of India Act, 1963 permits it to go up to 15%. A company refused to register UTI purchases because they were going beyond 5% and sought confirmation of the refusal from the CLB. It was held that the matter was outside the scope of S. 22A of the Securities Contracts (Regulation) Act, 1956 and, therefore, the CLB had no jurisdiction to deal with the matter. UTI was entitled to go by its own constitutional Act, and therefore, was not bound by SEBI regulations. *Kinetic Engineering Ltd. v. Unit Trust of India,* (1995) 84 Com Cases 910 (CLB—Bom).

This decision was **affirmed** by the Bombay High Court in *Kinetic Engineering Ltd. v. Unit Trust of India,* (1995) 84 Com Cases 910 : AIR 1995 Bom 194. The court also added that the Company Law Board exercises jurisdiction not merely under the Companies Act, but also jurisdiction which is conferred on it under other laws and, therefore, it can take into account other laws also for the purpose of deciding whether the impugned refusal was justifiable or not.

The line of interpretation adopted by the Supreme Court in some cases showed that special Acts prevail over general. *State of West Bengal v. Union of India,* AIR 1963 SC 1241; *Paradeep Port Trust v. Their Workmen,* AIR 1977 SC 36 and *LIC v. D.J. Bahadur,* AIR 1980 SC 2181.

Writ petition against CLB order under S. 111 not maintainable

Notwithstanding the guidelines provided by the CLB to company directors for their exercise of the power to refuse to accept a transfer of shares, *etc.*, the final approval of the directors' decision lies with the Company Law Board. The fact that the Board does not have the power of adjusting equities between transferees when it refuses to pass an order of registration of transfer, does not render the power of the CLB to be invalid. The Bombay High Court further held that a writ petition is not maintainable against an order of the CLB confirming the refusal by the company. *Alaknanda Mfg. and Finance P. Ltd. v. CLB,* (1995) 83 Com Cases 514 : AIR 1995 Bom 147; *Hong Kong Bank Agency P. Ltd. v. CLB,* (1995) 83 Com Cases 514 : AIR 1995 Bom 147; *Tracstar Investments P. Ltd. v. CLB,* (1995) 83 Com Cases 514 : AIR 1995 Bom 147.

Directors have no inherent powers to refuse [Sub-section (1)]

The principles of law and broad tests in respect of refusal to register transfer of shares have been laid down by the Supreme Court in the leading case of *Bajaj Auto Limited v. N.K. Firodia,* (1971) 41 Com Cases 1 : AIR 1971 SC 321. The Supreme Court held that: "Discretion (of directors to refuse transfer) does not mean a bare affirmation or negation of a proposal. Discretion implies just and proper consideration of the proposal in the facts and circumstances of the case. In the exercise of that discretion the directors will act for the paramount interest of the company and for the general interest of the shareholders because the directors are in a fiduciary position both towards the company and to a certain extent towards every shareholder. The directors are therefore required to act *bona fide* and not arbitrarily and not for any collateral purpose.

If the articles permit the directors to decline to register transfer of shares without stating the reasons, the court would not draw unfavourable inference against the directors because they did not give reasons. In other words, the court will assume that the directors acted reasonably and *bona fide* and those who allege to the contrary would have to prove and establish the same by evidence. Where however, the directors gave reasons, the court would consider whether they were legitimate and whether the directors proceeded on a right or wrong principle."

"It follows that where the directors have uncontrolled and absolute discretion in regard to declining registration of transfer of shares, the court will consider if the reasons are legitimate, if the directors have acted on a wrong principle or from corrupt motive. If the Court found that the directors gave reasons which were legitimate, the Court would not overrule their decision merely on the ground that the Court would not have come to the same conclusion."

Thus, in the context of refusal to register the transfer of shares, three basic tests have been laid down by the Supreme Court. *First,* whether the directors acted in the interest of the company; *secondly,* whether they acted on a wrong principle; and *thirdly,* whether they acted with an oblique motive or for a collateral purpose.

The Board of Directors of a company has no inherent powers to refuse to register a share transfer. Such a power has to be specified and provided for. It may even be a residuary power, but in that case too, it should be provided for and traceable either in the Act or in the Articles of Association. The words of sub-section (1) "or otherwise" in the expression "under its Articles or otherwise" do not mean that the company has inherent power to refuse registration of a transfer. *Luxmi Tea Company Ltd. v. P.K. Sarkar,* (1990) 67 Com Cases 518 (SC); *V.B. Rangaraj v. V.B. Gopalkrishna,* (1992) 73 Com Cases 201 : AIR 1992 SC 453; *Joy Holdings P. Ltd. v. Indian Railway Finance Corpn. Ltd.,* (1996) 85 Com Cases 13 (CLB—NB); *Madhujit Basu v. Dooars Assam Union Tea Co. Ltd.,* (1995) 5 Comp LJ 334 (CLB—Del).

When once completed documents for transfer of shares have been lodged with the company the transferee becomes entitled to be registered as a member in accordance with the articles of the company then in force. The company cannot deprive him of the rights

by subsequently changing the articles and giving the alteration a retrospective effect. *Vardhman Publishers Ltd. v. Mathrubhumi Printing & Publishing Co. Ltd.,* (1991) 71 Com Cases 1 (Ker) **following** *Luxmi Tea Company Ltd. v. P. K. Sarkar, (Supra).* The case of *Vardhman Publishers* came before the Division Bench in *Mathrubhumi Printing and Publishing Co. Ltd. v. Vardhaman Publishers Ltd.,* (1992) 73 Com Cases 80, 103 (DB) (Ker) where the Court found that when the transfer documents were first lodged, the lodgement was not valid and, therefore, the change of articles before the shares could be lodged again empowering the directors to reject a transfer of that kind was valid.

"Refusal means an express refusal to register. Where there was no refusal when the Board was equally divided and could not approve the transfer, the transferee was entitled to have his transfer registered. *In Re, Hackney Pavilion Ltd.,* (1924) 1 Ch 276. Where without any formal or specific refusal the Board of directors observed in their resolution that the application of the legal heirs of the deceased shareholder was effective in law and the managing director informed the applicants that their application for transmission could not be considered, it was held that this amounted to a refusal and, therefore, the petition under this section was maintainable. The petition was also maintainable by reason of the fact that the petitioners were legal heirs and the articles of the company provided for transmission of shares to the legal heirs of a deceased member. *Narinder Kumar Sehgal v. Leader Valves Ltd.,* (1993) 77 Com Cases 393 (CLB).

The present trend in the development of company law is to restrict the powers of the Board of directors to refuse registration of transfers. By virtue of the 1988 amendment, the company cannot refuse to disclose its reasons for refusal. *Joseph Michael v. Travencore Rubber & Tea Co.,* (1989) 66 Com Cases 491, 502 (Ker). In keeping with this principle, the Company Law Board refused to uphold the rejection of a transfer by the company on the ground that the transferor (the deceased joint shareholder) was the director of a company which was indebted to the company, the articles of the company containing no such provision, or that the transferee company had not commenced business within a year of its incorporation. The transfer was of 4.04 per cent of the total shareholding. The CLB found that this was not sufficient to bring about any change in the composition of the company's Board of directors. *Vijaya Commercial Credit Ltd. v. T.K. Alwa,* (1994) 79 Com Cases 656 (CLB).

In *Joy Holdings P. Ltd. v. Indian Railway Finance Corpn. Ltd.,* (1996) 85 Com Cases 13 (CLB—Northern Bench), the CLB held that there cannot be a blanket form of refusal to be applied to all cases without application of mind to the individual case. Acting on this principle, the CLB refused to see any justification in a refusal based on an omnibus resolution that the transfer of bonds by a company-member and its subsidiaries was to be refused in order to exert pressure on the member-company to settle its dues to the company. The company's refusal was struck down. In refusing a transferee, the transferee's position has to be examined as an individual case and not through the smokescreen of the transferor's good or bad relations with the company. To the same effect *Madhujit Basu v. Dooars Assam Union Tea Co. Ltd.,* (1995) 5 Comp LJ 334 (CLB—New Delhi).

The rejection on any grounds other than those mentioned in the article is not sustainable. *Hemangini Finance and Leasing P. Ltd. v. Tamilnad Mercantile Bank Ltd.,* (1996) 87 Com Cases 875 (CLB–Mad).

Refusal on the ground of restriction(s) contained in articles of association

This has become all the more necessary because since the amendment of 1988 it has become necessary to disclose reasons for the refusal and those reasons must emanate from one or the other grounds specified in the articles. For a view of the earlier cases in which the directors were compellable to disclose reasons, see *Sutherland v. British Dominions Land Settlement Corpn.,* (1926) Ch 746 and *Smith and Fawcett Ltd., Re,* (1942) 1 All ER 542 (CA).

Any restriction on transfer of shares which is not specified in the articles has no binding effect either on the company, its members and those who purchase shares from mem-

bers. The efficacy of this principle was tested in the decision of the Supreme Court in *V.B. Rangaraj v. V.B. Gopalakrishnan* (1992) 73 Com Cases 201 : AIR 1992 SC 453. The court looked at the relevant applicable provision in the company's articles and found that it contained no restriction on the right of a living member to transfer his holding either to an existing member or to a new member. The only restriction was that when the transfer was to a new member, it had to be approved by a majority of the members. The effect of the provision was that when the transfer was to an existing member, whether belonging to one branch of the family or another, consent of the majority was not necessary. The private agreement preventing the original founders as long as they were living from transferring to the other branch was contrary to the provision in the articles and, therefore, had no efficacy.

The first point to note in connection with the exercise of the power to refuse to register transfer of shares is that unless the articles confer any such power the Board cannot exercise such power and a refusal to register a transfer would be set aside by the Court. *Nandit Investment Co. Pvt. Ltd. v. Prem Chand Jute Mills Ltd.*, 1981 Tax LR 2557 (Cal).

The articles of association of almost all public companies, vest in the Board of Directors absolute and uncontrolled discretion to decline to register any transfer of shares. The adoption of such an Article does not mean that there is a restriction on the free transfer of shares as in the case of a private company. The object is to arm the directors with power to be exercised in special and exceptional cases where the transfer of shares may be found to be undesirable in the interests of the company. See *Raghuvanshi Mills Ltd. v. CIT*, (1970) 2 Comp LJ 113. In *Re, Smith and Fawcett*, (1942) 1 All ER 542 (CA), the Court of Appeal observed that even though the articles may give the directors absolute and uncontrolled discretion to refuse to register a transfer, a fiduciary power of this sort must be exercised *bona fide* in the interest of the company. *Mathrubhumi Printing and Publishing Co. Ltd. v. Vardhaman Publishers Ltd.*, (1992) 73 Com Cases 80, 105 (DB) (Ker). Subject to this restriction, the directors may refuse registration for any reason they think fit (*ibid*). In *Smith & Fawcette Ltd., Re*, (1942) 1 All ER 542 (CA), in a two-director two-member company holding equal number of shares, one died and the other refused to take his son as shareholder for the whole number of shares but offered to register him for half the number if the other half was transferred to him. The articles authorised the directors to reject a transferee if he was an undesirable person. In the exercise of this power he considered the son as desirable for a certain amount of shares but not beyond that. The court refused to interfere. This case was followed in *Popely v. Planarrive Ltd.*, (1997) 1 BCLC 8 (Ch D). The position here was that if the transferee was registered, he would have, alongwith his existing shareholding, gained control of the company as a shareholder and would use his power to gain control of the board. The articles provided for an absolute discretion to refuse a transfer. The board of directors decided to refuse him registration in respect of the additional shares though the board had knowledge that he was entitled to those shares. The court refused to interfere, relying upon the following observation:

As Lord GREENE MR said in *Re, Smith & Fawcett Ltd.*, (1942) 1 All ER 542 at 544 : "Private companies are, of course, separate entities in law just as much as are public companies, but from a 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." The court continued at [1997] 1 BCLC at p 16: "In such companies the directors will normally have private views as to the suitability of new shareholders (the estranged husband was trying to wrest control from his wife). It would be unrealistic and unworkable in many cases to require the directors to disqualify themselves in relation to the issue of registration of shareholdings merely because such views exist. No doubt if it can be shown that those private and personal feelings have been allowed to overcome the directors' views as to what is *bona fide* in the interests of the company, then a decision taken to refuse registration may be impeached. But if, say, directors believed that

registration of a new shareholder's shares would give him control of the company and that would not be interests of the company because he was a fraudster and liar, the decision to refuse registration could not be challenged simply because the new shareholder had defrauded all of the current directors. The fact that the directors had a personal dislike of the new shareholder would not alter the fact that their decision was taken *bona fide* in the interests of the company". "Once again Lord GREENE MR makes it clear that the directors must exercise their discretion *bona fide* in what they consider—not what a court may consider—is in the interests of the company, and not for any collateral purpose".

Applying the principles so stated, their lordships of the Privy Council in *Village Cay Marina Ltd. v. Acland,* (1998) 2 BCLC 327 (PC), held that there was no adequate basis upon which the Court of Appeal (Virgin Islands) was entitled to reject the findings of the trial judge that the directors rejected the transfer because they believed in good faith, for the reasons appearing in evidence, that the registration would not be in the interest of the company. Their Lordships observed that there was no rule of law by which directors were confined to the reasons they had given before.

Where the power of refusal is exercised after undue delay, the *bond fides* of such refusal will be open to question. See *Re, Swaledale Cleaners Ltd.,* (1968) 3 All ER 619 (CA). Similarly a refusal by a defectively constituted Board is no proper refusal. *Muir Mills Co. Ltd. v. T.H. Condon,* (1900) ILR 22 All 410.

Where by its Articles of Association a company reserves the right to refuse the transfer of shares, the burden is on the plaintiff to prove that the refusal to register the transfer was not *bona fide. Sri Tripurasundri Cotton Press Company Ltd. v. Adepalli Venkatappayya,* (1935) 5 Com Cases 243 (Mad); *Coimbatore Kamala Mills Ltd. v. T. Sundaram & Sons,* (1950) 20 Com Cases 61, 67 (Mad); *Jagdish Prasad v. Paras Ram,* (1942) 12 Com Cases 21: AIR 1941 All 360; *Popely v. Planarrive Ltd.,* (1997) 1 BCLC 8 (Ch D), burden on the refused transferee to show that the refusal was not *bona fide.*

If the Articles of Association restrict the exercise of the power to refuse transfer of shares upon which the company had a lien and in case of partly paid-up shares, it is not open to the Board of directors to refuse the registration of shares in cases not covered by those two contingencies. Where the bank was entitled to a lien over the shares in respect of dues and the transfer seemed to be of dummy nature, the refusal to register the same was held valid. *Madhav Rao Narayan Rao Patwardan v. The Miraj State Bank Ltd.,* (1983) 2 Comp LJ 69 (CLB). The expression 'or otherwise' in sub-section (2) [now sub-section (1)] cannot have the effect of enlarging the power to decline the registration of transfer of shares, or to so construe these words as to empower a company to decline the registration of the transfer even though such a power is not conferred by the articles of association, *Jalpaiguri Cinema Co. Ltd. v. P.N. Mukherjee,* (1971) 41 Com Cases 678; *Rangpur Tea Association Ltd. v. Makkanlal Samaddar,* (1973) 43 Com Cases 58; *Narayandas Giridhardas v. P. & O. Banking Corporation,* (1934) 4 Com Cases 166, 175 (Mad).

Where the relevant clause in the articles of association provides that all transfers of shares shall be sanctioned only with the unanimous decision of the directors, which provision is preserved by sub-section (1) and being not inconsistent with any provision of the Act, would be outside the reach of section 9. In the absence of any words of limitation such as the expression 'present and voting' in the phraseology of the articles, the article should be construed to mean that the sanction should be with the unanimous decision of all the directors of the company and a transfer, which is otherwise, valid, cannot be given effect to when it is based on a decision of the Board in a meeting at which one of the directors is absent. *Tarlok Chand Khanna v. Raj Kumar Kapoor,* (1983) 54 Com Cases 12 (Del).

Where the articles permitted refusal only on personal grounds, it was held that a refusal on the ground that the transferee was not a member of shipping companies was not justi-

fied. *Re, Bede Steam Shipping Co. Ltd.,* (1917) 1 Ch 123 (CA). Where the objections entertained by the directors to the transfer, although they were *bona fide* and believed to be in the interest of the company, were yet not personal to the applicants, they would not constitute legitimate reasons for refusing to register. *Bajaj Auto Ltd. v. N.K. Firodia,* (1971) 41 Com Cases 1 (SC); *Muir Mills Co. Ltd. v. T.H. Condon,* (1900) ILR 22 All 410; *Kaikhosro Muncherje Heeramahek v. Coorla Spg. & Wvg. Co.,* (1891) ILR 16 Bom 80.

In *Beena Barua v. Dalowjan Tea Co. P. Ltd.,* 1981 Tax LR 2592 : (1981) Gau LR 55 (Gauhati) a shareholder committed suicide because of family trouble. His wife applied for transmission of share in her name. The Board's refusal to accept the transfer on account of family quarrels was held to be not proper. The claim of the widow to obtain transmission in her own name, to the exclusion of minor children, was held to be unjustified because under the company's articles, the legal heirs had the right to claim transmission. The directors were held to be justified in refusing to transfer the share in the widow's name only.

The power under the articles to refuse to register is, however, a discretionary power which must be exercised reasonably and in good faith for the company's benefit; and in the absence of evidence to the contrary, it will be presumed to have been exercised properly. *Berry v. Tottenham Hotspur Football & Athletic Co. Ltd.,* (1936) 3 All ER 554 : (1935) 5 Com Cases 472. The commonly accepted principle all-along has been that "the court will not interfere with the exercise by directors of a discretion not to register a transfer if their decision was one which a reasonable Board of directors could *bona fide* believe to be in the interests of the company." Per VINELOTT, J. in *Tett v. Phoenix Property and Investment Co. Ltd.,* (1984) BCLC 599, 621. **Reversed** on another point in *sub-nom,* (1986) BCLC 149 (CA). Where the reasons given by the directors for refusal are legitimate, the court would not overrule their decision merely because that, if matter were to be decided by the court it would have come to a different conclusion. *Bell Bros. Ltd., Re,* (1891) 65 LT 245.

The power to refuse cannot be exercised arbitrarily or for any collateral purpose and can be exercised only for a *bona fide* reason in the interest of the company and the general interest of the shareholders. *Luxmi Tea Company Ltd. v. P.K. Sarkar,* (1990) 67 Com Cases 518 (SC); *Master Silk Mills Pvt. Ltd. v. Dharamdas Hargovindas Mehta,* (1980) 50 Com Cases 365 (Guj). Even where the directors enjoy a general and blanket power of refusal under the articles of the company, it does not become an absolute power. It too should be exercised only in the interests of the company and, in order to enable the Company Law Board or the court to examine whether it was so exercised, it is necessary that the directors should give their reasons. Where the directors of a banking company refused to accept a transfer without giving any reason but under the assumption that the transfer would be against the company's interest, the court held that the directors' apprehensions were absolutely unreal, the shares under transfer being a very insignificant part of the capital of the banking company. *K.V. Sasidhar v. Dhanalakshmi Bank Ltd.,* (1989) 2 Comp LJ 344 (CLB).

Prima facie, shares in companies are freely transferable. Where a power to refuse to register a transfer of shares is given by the articles, it can be exercised only by an express resolution of the Board refusing registration. The mere failure or omission to pass a resolution for registration is not enough nor is refusal by individual directors sufficient. There must be a decision of the Board. *Moodie v. W. & J. Shepherd (Book Binders) Ltd.,* (1949) 2 All ER 1044. The directors are in a fiduciary position both towards the company and towards every shareholder in it. The Court would interfere with any violation of the fiduciary duty so reposed in the directors where it is made out that the directors have been acting from some improper motive or arbitrarily or capriciously. *State of Orissa v. Indian Chemical Products Ltd.,* AIR 1957 Ori 203, 207, **relying** on *Gresham Life Assurance Society,* (1872) 8 Ch A 446. Where there are not any properly appointed directors the

power to refuse registration of shares cannot be exercised. *Re, New Cedos Engineering Co. Ltd.*, (1976) 120 Sol Jo 146 : (1994) 1 BCLC 797 (Ch D).

The articles of a public company cannot contain provisions destructive of free transferability. A provision in the articles of such a company was that a selling member would have to give notice to the board and the latter would act as an agent to sell the shares to other members either at an agreed price or, in the absence of agreement, at a price to be determined through arbitration. This provision was held to be a misfit with the concept of a public company. The company was directed to drop it. *Arjun S. Kalro v. Shree Madhu Industrial Estates Ltd.*, (1997) 1 Comp LJ 318 (CLB—PB).

Under Section 22A of the Securities Contracts (Regulation) Act, 1956, irrespective of the powers given in the Articles of Association, a company, whose securities are listed on a recognised Stock Exchange has the power to refuse registration of transfer of shares only on the grounds specified in sub-section (3) of Section 22A. *Bajaj Tempo Ltd., Re,* (1992) 73 Com Cases 451 (CLB).

The Company Law Board will not interfere if the directors have arrived at a fair decision in good faith in the interest of the company. In a case before Calcutta High Court the articles of a private company provided that shares would be transferable to family members only. Shares were transferred by a member to his brother, who was adopted by another family. It was held that the transferee ceased to be a member of the family. The directors also found that the transferee was a director of another company carrying on business in competition and which has filed a suit against the private company. The directors refused to register the transfer. The court refused to interfere in the matter. *Manohar Gobind Ram Talreja v. Mill Stores and Cotton Co. Pvt. Ltd.*, 1979 Tax LR 2106 (Cal). See also *Amraoti Electric Supply Co. v. R.S. Chandak,* (1954) 24 Com Cases 465, 470 : AIR 1954 Nag 293; *Kasi Viswanathan Chettiar v. Petroleum Co. Ltd.*, (1936) 6 Com Cases 42, 45 : AIR 1936 Rang 52.

Transfer by a member indebted to the company

Ordinarily directors cannot refuse a transfer on the ground that the transferring shareholder is indebted to the company in respect of calls or otherwise. They may refuse in such cases only on the authority of the provisions in the company's articles, *Ex. p, Stringer,* (1882) 9 QBD 436; *Re, Bentham Mills Spinning Co.*, (1879) 11 Ch D 900 (CA). The term 'indebted' as used in the articles of a company was held in *Re, Stockton Malleable Iron Co.*, (1875) 2 Ch D 101 to mean owing a debt due and payable. Where an article provided that the company might refuse to register a transfer by a member who was indebted, and another article provided for the registration of persons becoming entitled to a share in consequence of bankruptcy, it was held that the company was not justified in refusing to register a member's trustee in bankruptcy. See *Bentham* case, (*Supra*). Where directors with such a power to refuse nevertheless register a transfer, the transfer is valid but if the company suffers any loss the directors will be liable to make it good, *Re, Hoylake Rly. Co., ex p., Littledale,* (1874) 9 Ch App 257; *Cf. Anderson's* case, (1869) LR 8 Eq 509.

The member should be indebted at the time when the transfer is presented to the proper officer for registration and not when it afterwards comes before a Board meeting for consideration. *Re, Cawley & Co.*, (1889) 42 Ch D 209 (CA); *R. v. Inns. of Court Hotel Co., ex p., Rudolf,* (1863) 11 WR 806.

The director should be very cautious in exercising this power because should it afterwards turnout that there was no debt due from the member, they may have to pay nominal damages for denying him his right of free transfer; *Skinner v. City of London Marine Insurance Corpn.*, (1885) 14 QBD 882 (CA).

Refusal on ground of *mala fide*, purchase of shares

The Court can exercise control over the discretion of Board of Directors if they act capriciously or in bad faith, *Indian Chemical Products Ltd. v. State of Orissa,* (1966) 36

Com Cases 592 : AIR 1967 SC 253. If the directors decline to register the transfer with an ulterior motive or arbitrarily, the court can interfere and direct the company to enter the name of the transferee in the register of members, *Matheran Steam Tramway Co. v. B.N. Lang,* (1931) 1 Com Cases 206 (Bom).

Transferee a litigious and cantankerous person.—In *Feroz Sorali Wadia v. Particle Boards India Ltd.,* (CLB Decisions, p. 78), it was held that the fact that the transferee was a litigious and cantankerous person and would harass the management, is not valid and legitimate reason to refuse registration of share transfer. See also *Muir Mills Company Limited v. T.H. Condon,* (1900) ILR 22 All 410. Having regard to the size of the holding, which is one share, the appellant appeared to be incapable of harassing the management of the company or spread discontentment among its shareholders. *Shri Bhailal Hargovinddas Thakkar v. Nagri Mills Co. Ltd.,* (CLB Decisions, p. 203). Where, on the other hand, a person is of such a character as to throw the company into confusion and if he is not a desirable one, then the Board of directors will be acting in the best interests of the company in refusing to register the shares in his name and such a reason is a valid reason. *E.M. Muthappa Chettiar v. Salem Rajendra Mills Ltd.,* (1955) 25 Com Cases 283 : AIR 1955 Mad 665, **following** *Moffat v. Farquhar,* (1878) 7 Ch D 591 and *Gresham Life Assurance Society, Re,* (1872) 8 Ch App 446.

Transferee not a *bona fide* investor.—A shareholder of a company is entitled under the law to attend the general meetings of the company and he is expected to participate in the discussion on the affairs of the company at such meetings and to take decisions through resolutions passed thereat. The company made bald statement impeaching the character and conduct of the appellant suggesting that the appellant is not a *bona fide* investor of the shares and it has been his practice to purchase shares in various companies for the purpose of creating vexation, harassment and obstruction in the smooth working of the companies by creating trouble at the meeting of the shareholders. Relying on the Decision in *Bajaj Auto Ltd. v. N.K. Firodia, (Supra),* it was held that the refusal of the registration of transfer of shares was improper and unwarranted, *Basudeo Saraf v. India Jute Company Limited,* (CLB Decisions, p. 210). Where, however, on going through the copies of the correspondence exchanged, it was found that the appellant was meddling in the affairs of the company it was decided not to interfere in the decision of the Board. *Aditya Rungta v. D.N. Choudhury Cotton Mills Ltd.,* (CLB Decision, p. 242).

When the appellants affirmed that they were having individual incomes and that they are income tax payees, it should be deemed that they are *bona fide* investors. It is not proper to hold them undesirable persons only because it is alleged that one of them is inimical towards the company. *Miss Alka Agrawal v. Shree Vallabh Glass Works Ltd.,* (CLB Decisions, p. 158).

Duly lodged share transfers were refused by the Authorised Controller on the grounds that (a) the purchase of shares was aimed at acquiring further control of the company by the family of the erstwhile managing director; (b) the appellant voted against the resolution to approve the accounts reconstituted by the Authorised Controller on the managing director's failure to render the same; and (c) the acquisition of shares was not in the interest of the company which was proposed to be reconstructed by Government under the Cotton Textile Companies (Management of Undertaking and Liquidation or Reconstruction) Act, 1967. The Company Law Board held that the action of the Authorised Controller did not stand the tests laid down in *Bajaj Auto Ltd. v. N.K. Firodia, (Supra)* for the reasons that the acquisition of shares did not affect the interests of the company; the shareholders had no voice in management vested in the Authorised Controller; that every shareholder has a basic corporate right to vote according to his conscience and hence refusal on ground (b) *Supra* was based on wrong principle and that ground (c) was on oblique consideration, not germane to the exercise of the discretionary power, as the shareholder could only make a representation against reconstruction of the company, *Ghanshamdas Govindram Rungta v. Model Mills Nagpur Ltd.,* (CLB Decisions, p. 15) *Prabhavati Ghanshamdas Rungta v. Model Mills Nagpur Ltd.,* (CLB Decisions, p. 19);

Govindram Shivanarayan Rungta v. Model Mills Nagpur Ltd., (CLB Decisions, p. 20); *Basantkumar Bilasrai Rungta v. Model Mills Nagpur Ltd.,* (CLB Decisions, p. 21).

Where the refusal was on the ground that the investment was not genuine but no material was submitted to support this ground, it was held that the refusal was not legal and valid and, therefore, the company was directed to register transfer. *T.N. Kuriakose v. Premier Tyres Ltd.,* (1984) 1 Comp LJ 70 (CLB).

Ulterior motives of transferee.—When a person seeks to become a member of a company with ulterior motive, then it cannot be said that the decision of directors to refuse to register transfer of share is unjustified, *Feroz S. Wadia v. Kutch Salt & Allied Industries Ltd.,* (CLB Decisions, p. 131); *Feroz S. Wadia v. Maharashtra Sugar Mills Ltd.,* (CLB Decisions, p. 120); *Feroz S. Wadia v. Amar Dye Chemicals Ltd.,* (CLB Decisions, p. 122); *Feroz S. Wadia v. Siemens India Ltd.,* (CLB Decisions, p. 143); *Feroz S. Wadia v. Special Steels Ltd.,* (CLB Decisions, p. 148); *Feroz S. Wadia v. Ramon and Demm Ltd.,* (CLB Decisions, p. 150); *Feroz S. Wadia v. Air Control and Chemical Engineering Co. Ltd.,* (CLB Appeal No. 13 of 1978 decided on 24-12-1982).

Where the directors of a banking company refused to accept a transfer of shares involving more than 25% of the company's capital because it appeared to them that some unseen hand was directing the purchases, it was held that they had acted in good faith in the interest of the company; *Nathu Singh v. Punjab Co-operative Bank Ltd.,* (1996) 3 Comp LJ 74 (CLB).

Listed securities and transfer in odd lots.—If the company wished to adopt a restrictive policy for transfer of shares with reference to a transferable lot comprising certain minimum number of shares, it was expected of the company to have squarely told about this to the Stock Exchange, to have made a provision in its articles of association about non-transferability of shares in lots of less than 10 and to have spelled out the condition on the share certificates, to have issued share certificates in lots of 10 or more shares and to have specified in its articles of association about share certificates being not divisible. In the absence of aforesaid, refusal by the Board of Directors of the company to register the transfer of shares under appeal, in pursuance of its alleged policy, for which there is no policy resolution as such of the Board, is nothing short of misleading the prospective investors causing them unwarranted harassment. *Ramesh Chandra Gupta v. Raymond Woollen Mills Ltd.,* selected decisions of the CLB under section 111, P. 264, Published by the Department of Company Affairs. **Following** *Kumar Exporters P. Ltd v. Naini Oxygen Acetylene & Gas Ltd.,* (1985) 58 Com Cases 97 (All) the CLB held that: "It is quite clear that there is no prohibition under the Companies Act or any other Act for holding share certificates below market lot. The provisions of the law will override the provisions of articles of association or of the listing agreement. In the circumstances, the plea taken by the company is contrary to the provisions of section 22A of the Securities Contracts (Regulation) Act, and as such, the same cannot be accepted." *Dipak Kumar Jayantilal Shah v. Atul Products Ltd.,* (1995) 82 Com Cases 603 (CLB).

A company's Board of directors refused to register a transfer of 8 out of the transferring member's fifty shares. They contended that their articles did not permit transfer and registration of less than fifty shares. Since the company was listed in stock exchanges, the directors referred the matter to the Company Law Board for its approval. In the Board's opinion the company's rejection was wrongful. Section 22-A of the Securities Contracts (Regulation) Act, 1956 provides for free transferability of shares permitting listed companies only the four specified grouds of refusal. Any provision in the articles which is contrary to the requirements of the Act would be inoperative. Hence the provision in the company's articles that transfer should be only in acceptable market lots and not odd lots was of no avail. *Kinetic Engg. Ltd. v. Sadhna Gadia,* (1992) 74 Com Cases 82 (CLB). The CLB **followed** *Co-operative Central Bank Ltd. v. Addl. Industrial Tribunal,* (1970) 40 Com Cases 206 (AP); *Dipak Kumar Jayantilal Shah v. Atul Products Ltd., (Supra)* and *Kumar Exporters P. Ltd. v. Nani Oxygen Acetylene & Gas Ltd., (Supra).*

Contrary to the decisions cited in the para, the Company Law Board **approved** the decision of the board of directors in refusing such split transfers as would result in an odd lot of shares of less than fifty. *Kinetic Honda Motor Ltd. v. Pawan Gupta,* (1996) 86 Com Cases 596 (CLB—Bom).

Where the company has no objection to accepting a transfer in odd lots, the CLB cannot interfere. *Atul Products Ltd. v. Dipak Kumar Jayantilal Shah,* (1997) 88 Com Cases 876 (Guj) on appeal from *Dipak Kumar Jayantilal Shah v. Atul Products Ltd.,* (1995) 82 Com Cases 603 (CLB). To the same effect *Seshasayee Paper and Boards Ltd. v. Riddhi Chordia & Mool Chand Chordia,* (1998) 93 Com Cases 606 : (1997) 2 Comp LJ 249 (CLB—SB).

Creation of trust for disposal of odd lot shares

Circular, dated 8-10-1993.—In order to take care of the problems created by the refusal of transfer of odd lot shares by the companies a via media has been evolved by the Department of Company Affairs by providing for the creation of a trust for disposal of such shares. For the full text of the Circular No. 11/93, dated 8-10-1993 and Department's Press Note, dated 14-10-1993, see Notes under section 153-B and section 187-C.

Where, in the case of a rights issue, an application for registration was returned to the applicant in terms of the company's special resolution prohibiting transfers of fraction shares for a specified period and the application was made before that period, it was held that this was not a refusal. *S. S. Shah v. Tata Iron and Steel Company Ltd.,* (1992) 73 Com Cases 562 (CLB).

§ See also Notes under section 77A *ante.*

§ See also Notes under S. 108 under the heading "Application for split transfer and for less than market lots".

Secretarial Action Points for creation of trust for disposal of odd lots

1. Appoint an independent trustee not connected with the day to day management for the purpose of dealing with odd lot shares of investors.

2. Send a communication to the investors holding shares in odd lots to submit the same, along with completed transfer deeds, for disposal of the same by the trustees. Advertise the creation of trust in national and regional language newspapers and send notice to all the holders of odd lots.

3. Ensure that all share certificates along with transfer deeds received by the company are handed over to the trustees for disposal.

4. Ensure that the trustees appoint prominent brokers dealing with shares for disposing of the shares and do not indulge in manipulation of market rates with regard to the shares of the company.

5. Ensure that the shares received in odd lots are consolidated by the company and disposed of by the trustees.

6. Ensure that the trustees maintain a record of the share prices of the company and dispose of the shares at the best possible price.

7. Ensure that the trustees deal with odd lot shares only and not with any other shares, or with shares of any other company.

8. Send all fractional holdings in respect of rights and bonus shares to the trustees for holding the same on behalf of the original allottees.

9. Ensure that the trustees maintain proper books of account in respect of the transactions done by them and the books are kept open for inspection by ROC.

10. Ensure that the transactions done by the trustees are in the best interest of investors.

11. Pending disposal of the shares, the trustees are entitled to attend and vote at the meetings of the company as per the authorisation give by the original allottees.

Avoidance of inter-connection.—Where the paramount consideration of the company was that it did not want to get inter-connected with the appellant and its group, it was held that the reason will not hold good considering the smallness of the increase, if the shares are registered in the name of the appellant. At the same time, if it is the decision of the Board of the company that it should not get inter-connected with a group coming under the MRTP Act, 1969, it cannot be held that it is a *mala fide* decision. Accordingly, it was directed, as a condition in exercise of powers under section 637A of the Act, that the appellants shall not acquire any further shares in the company. *Golden Investments Limited v. Spencer and Company Limited,* (CLB Decisions, p. 184). The Board of Directors of the company had not acted on any wrong principle and their decision could not be branded as arbitrary or unjustified, if they genuinely believed that by such progressive increase in the shareholding of appellants, respondent got inter-connected with the group to which the appellants belonged, it would be disadvantageous for its growth and expansion which otherwise it would be able to do in the larger interest of the shareholders or the respondent would lose its independence, it could not be said that the directors had acted *mala fide* in rejecting registration of the transfer of shares, *Herbertsons Ltd. v. J.L. Morison Son and Jones (India) Ltd.,* (CLB Decisions, p. 248). In another case, the Board of Directors of the company believed that the appellants are not *bona fide* investors but are stooges of a business group who is making clandestine attempts to acquire control over the company and that the infilteration of the group, who are business rivals of the company, would be prejudicial to the interest of the company and its shareholders. The Board also apprehended that the association of the group, which is a MRTP house, with the company will hinder its growth as it may then be necessary to seek clearances *etc.*, under the MRTP Act. The decision of the Board of Directors of the company in the said circumstances was held to be not arbitrary or *mala fide. Sujata Jalan and others v. Superior Air Products Ltd.,* (CLB Appeals Nos. 8, 9, 10, 32/78 11, 12, 26, 27/79, 4/80, dated 13-2-1981); *Ramesh Kumar Sharma and others v. Hindustan Sanitaryware and Industries Ltd.,* (CLB Decisions, p. 152).

Transferee belonging to rival concern.—Where the transferee belongs to a rival concern, refusal of transfer will be justified. The appellant company had no investible surplus and the respondent company had not declared any dividend and its shares were selling below par in the market. Under these circumstances, the investment could not be considered to have been made *bona fide* with the intention of making profits. *Modi Carpets Ltd. v. Trans-Asia Carpets Ltd.,* (CLB Decisions in Appeal No. 26/80 dated 26-12-1981). The suspicion of the Board of Directors that the transferees are agents, nominees or associates of the managing director of the rival and competing concern, was not unfounded. The action of the Board of Directors in rejecting transfers in favour of the rival concern could not be said to be based on wrong principle, *Shri Ramchandra Vinayak Khare and other v. Aphali Pharmaceuticals Ltd.,* (CLB Decisions, p. 8) : (1995) 3 Comp LJ 108 (CLB—Delhi). Where after the dispute between the management and the employees arose and the management initiated disciplinary action against the employees, including the appellants, the appellants thought of becoming shareholders of the company as a strategy of counter-action, it could not be said that the action of the Board in rejecting the transfer was *mala fide* or for collateral purposes. *R. Krishnamurthy v. Amrutanjan Limited,* (CLB Appeals Nos. 2, 8, 9, 10, 11/81, dated 29-5-1982).

Undesirable conduct of transferee.—A company was held justified in taking into account the well known and also judicially noted circumstances that the appellant had been conducting himself in an unparliamentary and undesirable manner in company meetings and the Board of Directors rightly on the *bona fide* grounds decided to refuse to register the share transfer application. *Feroz S. Wadia v. Maharashtra Sugar Mills Ltd.,* (CLB Decisions, p. 120). See also *Xavier Joseph v. Indo Scottish Brand P. Ltd.,* (2002) 38 SCL 195 (CLB—Chennai).

Transferee trying to acquire control through purchasing shares.—Purchase of a large block of shares to acquire control if effected through permissible means cannot be

held to be unjustified. That by itself does not prove *mala fide* or bad faith either in fact or in law. Acquisition of control which the law permits cannot be illegal. *Virendra Prakash and others v. Anil Hardboards Ltd.,* (CLB Decisions, p. 177). Buying of large number of shares of a public limited company, particularly one which is quoted on the stock exchange is not bad by itself and any genuine investor, who has purchased shares out of his moneys, cannot just be asked to stay out of the company's management. If buying large number of shares of a company is to be called 'cornering of shares' then such 'cornering' per se or by itself cannot be called an illegal or prohibited act. And, if somebody buys a large chunk of shares of the company he cannot be kept out of the register of members of the company or cannot be debarred from becoming a shareholder of the company just because he may pose a threat to the power and position of the present directors of the company, *Dhanraj Mills Private Ltd. v. Killick Nixon & Co. Ltd.,* (CLB Appeals Nos. 15 to 17 of 1980, dated 8-7-1982). Likes and dislikes of individuals cannot be taken into account, particularly when the shares purchased were not sufficient to give any chance of take over of the company. *Ganesh Flour Mills Company Ltd. v. T.P. Khaitan,* (1986) 60 Com Cases 28 (Del).

In *B. Rajagopal Naidu (Deceased) v. Thirumagal Mills Ltd.,* (CLB Decisions, p. 48) the CLB held that the company was not correct in refusing to register transfer of shares in favour of the appellant who had already been a member and a director. Moreover so, because the shares acquired by him, including those already held, were not sufficient to give any slight chance of acquiring control of the respondent company.

Undesirable transferees.—The CLB held in another case that there was no justification to deny the acquisition of shares with no evidence to indicate that the appellant was not a desirable investor, and especially when he had, undertaken not to purchase any further shares of the company, *Kishor Lal Prabhu Lal Ghiya v. Hindustan Oxygen Gas Co. Ltd.,* (CLB Decisions, p. 83); *N.R. Ghia v. Hindustan Oxygen Gas Co. Ltd.,* (CLB Decisions, p. 73).

Objection of undesirability should be personal to transferee.—In an allegation that the appellant is not a desirable person to be taken as member of the company, the accent should always be on a personal objection attributable to the transferee and not on somebody else who is undesirable. Otherwise, all the members of a joint Hindu family would have to be condemned as undesirable persons for acquiring corporate shares, if at any time in the past any member of that family had occasion to be branded as having mismanaged any company. *R.R. Morarka v. Belapur Sugar and Allied Industries Ltd.,* (CLB Decisions, p. 85); *Pavan G. Morarka v. Belapur Sugar & Allied Industries Ltd.,* (CLB Decisions, p. 99); *Narpatmal Bhandari v. Belapur Sugar & Allied Industries Ltd.,* (CLB Decisions, p. 139). An essential attribute of listing is free transferability of company's shares. Unless there are valid and strong grounds, which should generally speaking be those clearly spelled out in the articles of association of the company, the transferability of shares should not be blocked. *Dilipsi Dwarkadas & Rajendra Dwarkadas v. Amruta Mills Ltd.,* (CLB Decisions, p. 271); *Panbai Talkshi Shah v. Centron Industrial Alliance Ltd.,* (CLB Appeals Nos. 7 *etc.* of 1980, dated 15-5-1981); *Nice Traders & Investors Pvt. Ltd. v. Special Steels Ltd.,* (CLB Appeal No. 12 of 1980, dated 29-8-1981).

Transferee devising strategy for liquidation.—Where the policy of a company was to keep only those shareholders who had not advocated its liquidation, the company was held to have rightly refused to register certain shares in the name of a person who has no interest in the company and had been advocating its liquidation and did not want the company to carry on business under any circumstances. *Sohan Singh v. PNB Finance Ltd.,* (CLB Decisions, p. 146).

Transferee devising strategy to drag company into litigation.—Where an acquisition of the shares had not been made as genuine investment but only to acquire membership rights for the purpose of taking other actions available under the Act, the decision of the directors in refusing registration of transfer was fully justified. *Somesh Sengupta v.*

Eastern Dooars Tea Co. Ltd. and Siddly Dooars Tea Co. Ltd., (CLB Decisions, p. 70); *Basudeo v. Superior Air Products Ltd.*, (CLB Appeal Nos. 14 and 15 of 1981, dated 20-10-1981); *Amaxco Investments Pvt. Ltd. v. Superior Air Products Ltd.*, (CLB Appeals No. 16 of 1981, dated 21-10-1981). It is a well known principle of company law that the discretion of the Board of Directors to refuse registration of share transfers should be interfered with by tribunals or Courts having statutory authority to do so, only if the decision is *mala fide*, based on wrong principles and arrived at for ulterior purposes. In this case, the appellant had not been able to establish any lack of *bona fides* on the part of the Board of Directors. *Feroze S. Wadia v. Prof. Gajjar's Standard Works Ltd.*, (CLB Decisions, p. 112); *M.N. Patwardhan v. Miraj State Bank Ltd.*, (CLB Appeal No. 28 of 1979, dated 27-12-1982).

Where the transferee is a person whose activities are against the company's interest, the directors may properly refuse to register the transfer. *Amirthalingam M.G. v. Gudiyatham Textile Ltd.*, (1972) 42 Com Cases 350 (Mad). But the mere fact that the transferee had at some time past taken proceedings to have the company wound up is not sufficient, *Rangpur Tea Association Ltd. v. Makkanlal Samaddar*, (1973) 43 Com Cases 58.

Refusal to be in interest of both company and shareholders.—Even if the directors are the majority shareholders, the power to register or refuse to register transfer must be exercised in the interest of both the company and the shareholders and not merely in their personal interest. *Heron International Ltd. v. Lord Grade*, 1983 BCLC 244 (CA). LAWTON LJ said [at pp. 264-5] : "This duty to determine which person shall acquire and be registered as the holder of [shares] is a fiduciary power which the directors must exercise in the interests of the company and in the interests of the shareholders of the company..... Where directors have decided that it is in the interests of a company that the company should be taken over, and where there are two or more bidders, the only duty of the directors, who have powers [to refuse to register transfers], is to obtain the best price. The directors should not commit themselves to transfer their own voting shares to a bidder unless they are satisfied that he is offering the best price reasonably obtainable. Where the directors must only decide between rival bidders, the interests of the company must be the interests of the current shareholders. The future of the company will lie with the successful bidder. The directors owe no duty to the successful bidder or to the company after it has passed under the control of the successful bidder. The successful bidder can look after himself, and the shareholders who reject the bid and remain as shareholders do so with their eyes open, having rejected that price which the directors consider to be the best price reasonably obtainable."

Signature not tallying with specimen.—There is no legal infirmity in a public company refusing to accept a transfer of shares where the signature of the transferor on the transfer form does not agree with his specimen signature in the records of the company. On the facts of the case, however, the signature was that of an authorised person and the company's contention was that the authority letter was not there with the company. The transferee's stand was that three powers of attorney were filed on behalf of the registered holders. The National Stock Exchange was not allowed to declare that the lodgement was a bad delivery. *Investment and Portfolio Management v. NSE of India*, (1997) 89 Com Cases 191 (Bom).

Where there is a dispute about the genuineness of signatures of the transferor upon transfer forms as submitted by the transferee, the Company Court should relegate the petitioner to a civil suit for a declaration that he is the rightful owner of the debentures in question *Indian Bank v. Deepak Fertilizers & Petrochemicals Corpn. Ltd.*, (1999) 35 CLA 389 : (1999) 21 SCL 224 (Bom). See also *Tarsen Kansil v. Dev Spinners Ltd.*, (2000) 37 CLA 132 : 2000 CLC 957 : (2000) 24 SCL 519 : (2001) 103 Com Cases 835 (CLB–NB) a case which involved forgery, misrepresentation, manipulation, referred for civil court adjudication.

Department's Circular.—Reference is invited to para 14(*iv*) of the minutes of the 26th Meeting of the Standing Committee of Presidents of Stock Exchanges held at Madras on the 8th and 9th December,

1978 according to which it was decided to amend the listing agreement to make it obligatory on the part of the company to disclose in the objection memo, address of the registered shareholder while returning the documents under objection for non-tally of his signature to facilitate easy contact with him. The question of amending the listing agreement to incorporate the above decision of the Standing Committee has been considered by the Government. While it may not be necessary to amend the listing agreement to provide for the matter, stock exchanges are hereby directed to advise the companies listed with them to comply with the above decision of the standing Committee of Presidents of Stock Exchanges. (*No. F 1/43/80, dated 8-10-1980, issued by Stock Exchange Division, Department of Economic Affairs*)

Refusal on frivolous grounds.—Where a company kept refusing to accept a transfer on one ground or the other, *e.g.* grounds like this that signature did not agree, or that the transferee's induction would be against the interest of the company, it was held that it was not a *bona fide* conduct on the part of the company nor in the interest of the company. The correctness of the company's decision could not be examined under a reference under the Securities Contracts (Regulation) Act. For that purpose the company itself had to make a reference within two months of the lodgment which it had not done. *Techno-electric and Engg. Co. Ltd. v. Payal Singh,* (1992) 1 Comp LJ 334 (Cal).

Department's Circular I.—It has been brought to the notice of this Department that certain companies are returning instruments of transfer without effecting transfer of shares in the names of transferees on frivolous grounds, *inter alia*, that the specimen signatures of transferors do not tally with that on record, in spite of the fact that the transfer forms bear attestation of the magistrates, *etc.* In this connection, it may be stated that as per instructions below the prescribed share transfer form (No. 7-B) "attestation, where required, of thumb impression, marks, signatures, *etc.*, should be done by a magistrate, notary public or special executive magistrate or a similar authority holding a public office or a member of a recognised stock exchange through whom the shares are introduced or a member of the transferor's bank." Further, the guidelines for good or bad delivery issued by the Ministry of Finance, Department of Economic Affairs, *vide* their *Circular No.* 1/10/SE/83, dated 21-7-1983 also provide a similar requirement. You are, therefore, requested to advise your constituent member companies to follow the aforesaid instructions scrupulously and to effect transfer of shares within the period prescribed under section 113 of the Companies Act, 1956, and the listing guidelines. [*Circular No.* 3 of 1993, dated 22nd March, 1993]

Department's Circular II.—Refer to this *Department's Circular No.* 3/93, dated 22-3-1993 on the above subject, [Printed above] in which companies were advised not to return transfer deeds on the ground, *inter alia*, that the signatures of the transferor do not tally, where the same are attested by Notary Public, Stock Broker, Magistrate, *etc.*, and to say that it has been represented to this Department that in some cases, although the signatures are attested by Notary Public, the same do not tally or the signatures have not been properly attested, which may give rise to disputes. In view of these representations, the companies concerned are advised to satisfy themselves where there is doubt/apprehension about the genuineness of signatures by making a reference to the transferor. Such cases will, however, be more by way of exception rather than as a general rule. [*Circular No.* 10/93 F. No. 3/4/92-CL-V, dated 13-8-1993].

Where FERA (now FEMA 1999) permission necessary.—A transferee who has the right to get on the register where no permission is required or where permission has been obtained, may ask the company to register the transfer and the company cannot refuse to register the transfer except for a *bona fide* reason, neither arbitrarily nor for any collateral purpose. The paramount consideration is the interest of the company and the general interest of the shareholders. *Life Insurance Corporation of India v. Escorts Ltd.,* (1986) 59 Com Cases 548 at 618 : AIR 1986 SC 1370. Where the requisite permission under FERA [*now FEMA*] is not obtained, the company cannot register the transfer of shares in favour of a non-resident. But, once the permission is obtained whether before or after the purchase of shares, the company cannot refuse to register the transfer. Nor is it open to the company or any other authority or individual to decide whether the permission was rightly granted by the Reserve Bank. *Life Insurance Corporation of India v. Escorts Ltd.,* at p. 618 of Com Cases (*Supra*).

A company filed a petition before the CLB seeking rectification by deleting the names of non-resident Indian shareholders for their failure to obtain RBI permission. The court upheld the rejection of the petition by the CLB saying that such permission could have been obtained *ex post facto*. The petition was filed 10 years after the investment. The court rejected the petition, being *mala fide* and filed only for the purpose of ousting the non-resident shareholder from the membership of the company. *P.K. Prathapan v. Dale*

and Carrington Investments P. Ltd., (2002) 111 Com Cases 425 (Ker); (2002) 38 SCL 827 : (2002) 3 Comp LJ 281 : (2002) 50 CLA 171 : 2002 CLC 1480.

Where special permissions are necessary.—Where the transfer in question could be effected only with the permission of Special Court (Trial of Offences Relating to Transactions in Securities) Ordinance, 1992, it was held that the refusal by the company to accept the transfer without such permissions was justified. *Castrol India Ltd. v. S.S. Mehta*, (1993) 78 Com Cases 146 (CLB).

Stay of proceedings before CLB.—Where shares were purchased from a non-resident company with RBI permissions which imposed conditions and there was petition before the Company Law Board against the company's refusal to accept the transfers, it was held that though the transferor company was impleaded in the petition, it had no right to ask for stay of petition on the ground that there was a dispute as to title and the sale agreement provided for arbitration. The dispute before the CLB was between the petitioner and the company and not between the transferor and transferee. *Insotex (India) Ltd. v. AEG-NGEF Ltd.*, (1995) 83 Com Cases 358 (CLB) **affirmed** by the Karnataka High Court in *AEG-Aktiengesellschaft v. Insotex (India) Ltd.*, (1995) 83 Com Cases 677: AIR 1996 Kant 69.

Transfers in violation of S. 372.—The Company Law Board has recognised that it may be lawful for a company to refuse to register a transfer of shares which is void by reason of violation of the restrictions contained in s. 372 [see now sec. 372A]. *Gordon Woodroffe Ltd. v. Trident Investment and Portfolio Services P. Ltd.*, (1994) 79 Com Cases 764 (CLB—Mad).

Where resolutions under sections 292 and 372 necessary.—Resolution under section 292 is necessary for a body corporate, while purchasing shares of a company because in the absence of such a resolution authorising someone to execute transfer on behalf of the company and to make investments in the shares of the company no execution of transfer can be made. The company can proceed on the basis that this being a matter of internal requirement, the transferee company must have complied with the provisions of sections 292 and 372. However, the Board of directors of a company, while considering the registrability of the transfer can certainly ask for a copy of such a resolution in order to be sure that the instrument of transfer had been duly executed and that the investment made was within the authority of the person to whom the power to execute the transfer had been delegated. Once asked to do so, the transferee company cannot refuse to deliver a copy of the resolution. A copy of such resolution must be simultaneously forwarded. The company whose shares were under transfer should have proceeded on the basis that compliance of the provisions of sections 292 and 372 of the Companies Act, 1956, being a matter of internal management, the transferee companies must have complied with these provisions of law specifically when there is no evidence available with that company to the contrary. Thus, the resolutions passed by the Board of directors of the transferee companies for making certain investments were *prima facie* in compliance with the provisions of sections 292 and 372 of the Act. Therefore, the rejection of registration of transfer of shares by the company on this ground was not according to law. *Jagatjit Industries Ltd. v. Mohan Meakin Ltd.*, (1994) 80 Com Cases 411 (CLB).

Shares purchased under benami transaction.—The company objected to a transfer on the assumption that the transferee was a *benami* of an undesirable person. It was held that the objection should be personal to the transferee and should not be on account of the fact that the transferee is a *benami* of some other person whom the directors do not approve. *V.S. Ratnam v. Ossor Estates Ltd.*, (1989) 3 Comp LJ 355, 359 (CLB). Violation of the *Benami* Transaction (Prohibition) Act, 1988 can be taken into account in deciding the question of validity of the transfer. *Gordon Woodroff P. Ltd. v. Trident Investment and Portfolio Services P. Ltd.*, (1994) 79 Com Cases 764 (CLB—Mad).

Unless it could be shown that someone had paid the consideration for registering the shares in somebody else's name, no violation of section 3 of the Benami Transactions

(Prohibition) Act, 1988 could be established. If the respondent merely made a loan to two companies and the shares had been purchased by those two companies out of the money belonging to them, that would be no evidence to show that the shares were held in the name of someone else. Nor was it anybody's case that the two companies had paid the consideration to the respondent and wanted the respondent to act as *benamidar*. *Taxmaco Ltd., In re,* (1996) 1 Comp LJ 154 : (1991) 5 Corpt LA 353 (CLB—Cal).

The Company Law Board has distinguished transactions of financing sale and purchase of shares from those of *benami* purchases. The distinction became necessary for the purpose of ascertaining the true nature of a transaction in which a group of companies purchased shares of a single company and the consideration was provided by one company or the other depending upon availability of funds with the one or the other and subsequently repatriating the same and treating it in the meantime as temporary loans. The CLB held that this was a transaction of mutual financing and not a *benami* transaction. If such transactions were to be regarded as *benami* dealings, transactions for sale-purchase of shares to the tune of crores of rupees being financed through bank or institutional money would all fall within the mischief of the Benami Transactions (Prohibition) Act, 1988. *Hemangini Leasing P. Ltd. v. Tamilnad Bank,* (1996) 86 Com Cases 875 (CLB—Mad).

Refusal on the ground of failure to affix/cancel adhesive stamp on transfer deed*

Under section 108(1), a company cannot register a transfer of shares unless a proper instrument of transfer duly stamped and executed by or on behalf of the transferor and the transferee has been delivered to the company along with the share certificates in question. The expression, 'duly stamped' has not been defined in the Companies Act. Under section 2(11)) of the Indian Stamp Act, 1899 'duly stamped' as applied to an instrument, means that the instrument bears an adhesive or impressed stamp of not less than the proper amount and that such stamp has been affixed or used in accordance with the law for the time being in force in India. Under section 12(1) of the Stamp Act, whoever affixed an adhesive stamp to an instrument which has been executed by any person shall, when affixing such stamp, cancel the same so that it cannot be used again. Sub-section (2) thereof makes it clear that any instrument bearing an adhesive stamp which has not been cancelled so that it can be used again, shall so far as such stamp is concerned, be deemed to be unstamped. Sub-section (3) thereof provides the manner in which the adhesive stamp can be cancelled and provides that the stamp be cancelled by writing on or across the stamp his name or initials or the name or initials of his firm with the true date of his so writing, or in any other effectual manner. An instrument to be duly stamped should be stamped with a stamp not only of the required value but also in the manner prescribed by law. *Motilal v. Jagan Mohan Das,* 6 Bom LR 699. Section 17 of the Stamp Act makes it clear that all instruments chargeable with duty and executed shall be stamped before, or at the time of execution. Therefore, the legal requirement is that the stamp must be put either before or at the time of execution. *Babulal Choukhani v. Western India Theatres Ltd.,* (1958) 28 Com Cases 565 : AIR 1957 Cal 709; *Canara Bank v. Ballarpur Paper and Strawboard Mills Ltd.,* (CLB Decisions, p. 137).

The true test for determining whether an adhesive stamp has been effectually cancelled is whether an ordinary conscientious man, on seeing the stamp would arrive at the conclusion that the stamp has already been used. *Passumal v. Gangamal,* AIR 1921 Sind 77. The cancellation of a stamp by a person may be done sufficiently by writing his name or putting his signature across it; it is not necessary that he should put the date on it. *Kirpa Ram v. Barumal,* 3 All LJ 326. A stamp may be effectively cancelled by merely drawing a line across it. *Mahadeo Kori v. Sheoraj Ram Teli,* AIR 1919 All 196. But, if it is possible to use the stamp a second time in spite of a line being drawn across it, there is no effectual cancellation. *Hafiz Allah Buksh v. Dost Mohammed,* AIR 1935 Lah 716. A very

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* For a detailed commentary on the subject refer "K. KRISHNAMURTHY INDIAN STAMP ACT", 8th Edn., 2002.

effective method of cancellation is the drawing of diagonal lines right across the stamp with ends extending on to the paper of the document. A cross mark on to the stamp by an illiterate person indicating his acknowledgment is an effective cancellation of the stamp. *Mela Ram v. Brij Lal,* AIR 1920 Lah 374.

Crossing a stamp by drawing a line and signing on the adjacent stamp was held to be not a cancellation of the first stamp. *U. Kvaw v. Hari Dutt,* AIR 1934 Rang 364. Where one of the two stamps was not duly cancelled, it was held that the promissory note must be deemed to be unstamped and inadmissible in evidence since one stamp alone was insufficient for the promissory note. *Babu Lal v. Durga Prasad,* AIR 1940 Oudh 308. If the stamp is not cancelled, then the effect is the same as if the instrument is not stamped and the company is right in contending that the transfer deed is not duly stamped. In *Re, Coronation Tea Company Ltd.,* AIR 1961 Cal 528 : (1962) 32 Com Cases 568. In *Tara Prasad Chakravarty v. Orissa Textile Mills,* (CLB Decisions, p. 1); *Madan Lal Patodia and others v. Laxmi Narayan Cotton Mills Ltd.,* (CLB Decisions, p. 22); *Sukumar Roy and others v. Dabijhore Tea Co. Ltd.,* (CLB Decisions, p. 64); *Basudeo and others v. Superior Air Products Ltd.,* (CLB Decisions, p. 198); *Praveen Sharada v. Chopanshi Ice Aerated Water and Oil Mills Ltd.,* (CLB Appeal No. 1 of 1982, dated 10-1-1983); *Arun Kumar Jagnany v. Hindustan Motors Ltd.,* (1984) 2 Comp LJ 270 (CLB); **followed** in *Muniyamma v. Arathi Cine Enterprises P. Ltd.,* (1993) 77 Com Cases 97 (Kar—DB); *Smit P. A. Dhanakshmy v. Sitaram Anglo Ayurvedic Pharmacy Ltd.,* (CLB Appeal No. 5 of 1981, dated 27-7-1982); *Smit C. Shantakumari v. Sitaram Anglo Ayurvedic Pharmacy Ltd.,* (CLB Appeal No. 6 of 1981, dated 29-7-1982); *K. Inasu Kuriakose and another v. Sitaram Anglo Ayurvedic Pharmacy Ltd.,* (CLB Appeal No. 24 of 1981, dated 17-9-1982).

The plea that if the adhesive stamps had to be cancelled, the company could have easily done it, was rejected by the Court. *In re, Coronation Tea Co. Ltd.,* (1962) 32 Com Cases 568 : AIR 1961 Cal 528. The Notification No. 6714 dated 18th July, 1941 [*Calcutta Gazette,* dated July 14, 1941] merely contemplates a second cancellation by the company to render the stamps permanently unfit for reutilisation.

The Company Law Board held that unless the adhesive stamp affixed to the transfer deed is cancelled by the executant of the deed in accordance with the provisions of section 12 of the Stamp Act, legally the share transfer deed is not duly stamped and under section 108(1) of the Companies Act, it is mandatory that a company shall not register transfer of shares unless a properly executed instrument of transfer 'duly stamped' has been delivered to the company. See *Chandrashekhar Hari Joshi v. Bombay Papers Ltd.,* (1991) 72 Com Cases 173 (CLB). To the same effect *C.H. Joshi v. Bombay Papers Ltd.,* (1994) 2 Comp LJ 264 (CLB) **following** *Tara Prasad Chakravarty v. Orissa Textile Mills,* Appeal No. 6 of 1970 decided on December 28, 1972 (CLB).

A company can reject a transfer where the transfer document does not satisfy the legal requirement of stamping and it is not necessary that the company should give the parties an opportunity to rectify matters. *K.C.P. Ltd. v. E.I.D. Parry (India) Ltd.,* (1996) 87 Com Cases 361 (CLB).

Time of cancellation of stamps.—In *Mathrubhumi Printing and Publishing Co. Ltd. v. Vardhman Publishers Ltd.,* (1992) 73 Com Cases 80 (Ker—DB) it was held that a share transfer form to be properly executed and the stamps must be cancelled at the time of the execution. If the same were left to be cancelled at a subsequent stage and then before the instrument is delivered to the company the stamps are cancelled, it would not be good delivery.

§ Also see Notes under section 108 under the heading 'Stamp duty on transfer'; 'Duly Stamped'.

Who has to bear Stamp Duty.—Under section 29 of the Stamp Act, in the absence of an agreement to the contrary, the expenses of providing the proper stamp shall be borne by the person drawing, making or executing such instrument. In *Jainarain Ram Lundia v.*

Suraj Mull Sagarmull, AIR 1949 FC 211, the Federal Court held that ordinarily and as a matter of law, in the case of a contract of transfer of shares in a company, it was the vendor who was liable for stamp duty. The matter arose out of a contract to sell shares and the question for the consideration of the learned Judges of the Federal Court was whether the contract was complete or not. The party challenging the contract contended that no agreement had been arrived at regarding the payment of the stamp duty on the transfer deed and, therefore, the transfer could not be said to be complete. It was contended, on the other hand, that the question of payment of stamp duty was not one of the terms of the contract as ordinarily stamp duty was paid by the transferor. This contention was accepted by the learned Judges of the Federal Court who held that in law it is the transferor who pays the stamp duty, and the absence of any agreement on this point could not invalidate the contract. The Punjab High Court in *G.R. Parry v. Union of India,* (1962) 22 Com Cases 145, held that the transferee is not liable for paying stamp duty simply because an instrument of transfer of shares is required to be executed both by the transferor and the transferee. There is no provision in the Companies Act or in the Stamp Act which would make the company liable for payment of the proper stamp duty and that the liability to pay stamp duty in the case of instrument of transfer of shares is upon the executant and that liability cannot be considered to have been duly discharged by the mere fact that the amount required for purchasing the stamps has been paid to the company by the appellant. *V. Kabaleeswaran v. Varalakshmi Fund (Vellore) Ltd.,* (CLB Decisions, p. 53).

Purchaser's duty as to stamps.—In *Muniyamma v. Arathi Cine Enterprises P. Ltd.,* (1993) 77 Com Cases 97 (Ker) the court restated the same principle of law as established through decisions in cases like *Nuddea Tea Co. Ltd. v. Ashok Kumar Saha,* (1988) 64 Com Cases 775 (Cal); *Nirmal T. Shah v. Shravathi Petro-Chemicals,* Petition No. 38 of 1980 (decided on 10-10-1984); *Arun Kumar Jagnany v. Hindustan Motors Ltd.,* (1984) 2 Comp LJ 270 and *Mathrubhumi Printing and Publishing Co. Ltd. v. Vardhman Publishers Ltd.,* (1992) 73 Com Cases 80 (Ker). The court also pointed out that in a petition under this section the court cannot go into the question of the validity of transfers in favour of other persons similarly circumstanced but who were not before the court. The decision of the single judge (*Muniyamma v. Arathi Cine Enterprises P. Ltd.,* (1991) 72 Com Cases 555) was to this extent **reversed** and the transferor's plea allowed that they were entitled to a declaration that they were still the shareholders of the company because the transfer of the shares by them was not valid.

§ See also Notes under s. 108 under heading "Stamp duty on transfer"; 'Duly Stamped'.

Position of private and deemed public companies*

The very definition of private company [*vide* section 3(1)(iii)(a)] requires that it should, by its article, restrict the transfer of its shares, and its total number of members is also limited. Under the circumstances, a wide discretion is vested in the directors. See *Borland's Trustees v. Steel Bros.,* (1901) 1 Ch 279.

It has been held, following earlier authorities, that all the provisions of section 111 are applicable to private companies except to the extent provided in sub-sections (11) and (13) and, therefore, the jurisdiction created by the section is equally available for rectification of the register of members of a private company. Accordingly, if the directors of a private company make an allotment of shares which is liable to be set aside, the matter can be taken care of under this section. In a case before the Company Law Board, *Jitendra Nath Saha (Dr.) (NRI) v. Shyamal Mondal,* (1995) 82 Com Cases 638 (CLB), the directors of a private company had the power under the company's articles to increase capital and allot it in any manner they thought fit. This absolute power was held to be not

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* By virtue of sub-section (14) inserted in section 111 by the Depositories Act, 1996 (w.e.f. 20-9-1995), the provisions of section 111 are applicable to private companies and to deemed public companies under section 43A [The concept of deemed public company' has been abolished by the Amendment Act, 2000].

exercisable arbitrarily. Allotment had nevertheless to be made in a manner fair to all the shareholders. The directors' conduct in allotting the whole number of shares to themselves to the exclusion of others and that too for the purpose of obtaining control of the company was held to be wrongfully entitling the shareholders so excluded to challenge the validity of the allotment and rectification of the register by setting aside the allotment.

The fact that a deemed public company is not on all fours with a public company, is amply evidenced by the various provisions of the Act. For example, the number of members of a public company cannot fall below 7 without attracting the serious consequences provided in section 45 (personal liability of the members for the company's debts) and section 433(d) (winding up in case the number falls below 7). In contrast, a private company which has come within the purview of section 43A can still maintain its separate corporate identity *qua* debts even if the number of its members is reduced below 7 and it has also no liability to be wound up for that reason. This distinction between a deemed public company and a public company is also manifested by sections 174 and 252 of the Act. While a public company is necessarily required to have 3 directors, no such obligation has been cast on a private company which has become a deemed public company, which need have only 2 directors. Also, as against five members which constitute a quorum for a general meeting of a public company, for a deemed public company the quorum is only 2. If the intention of the Legislature was that a private company on its becoming a deemed public company under section 43A should be treated at par with a public company for the purpose of the appeal provisions of section 111(3), it would have been so stated therein, as has been done in respect of a private company which is subsidiary of a public company. The expressions ".....the private company shall..... become by virtue of this section a public company", ".....the private company shall..... become ..... a public company by virtue of this sub-section", "within 3 months from the date on which a private company becomes a public by virtue of this section....." and "a private company which has become a public company" in sub-sections (1), (1A), (2) and (4) of section 43A, lend support to the view that a deemed public company is different from a public company as defined in section 3(1)(iv). On a proper appreciation of the various other provisions of the Act, the inference is inescapable that a deemed public company is to be taken as a private company as defined in section 3(1)(iii), and not as a public company as defined in section 3(1)(iv), for the purpose of appellate jurisdiction under section 111(3) of the Act. *Mohd. Erfan Randarian v. Randarian & Singh Ltd.*, (CLB Appeal No. 10/80, dated 2-11-1981); *Naina Deepak Kamani v. Kamani Tubes Ltd.*, (1983) 3 Comp LJ 486 (CLB). It may be stated that the proposition of law laid down in this judgment is still valid in case refusal is based on the restrictions contained in the articles of association of a section 43A deemed public company.

Restriction on right to transfer shares in case of private companies

The directors in a private limited company have wide discretion in the matter of registration of transfer of shares and unless it is proved that they acted *mala fide*, the courts will not interfere. *P.V. Chandran v. Malabar & Pioneer Hosiery (P.) Ltd.*, (1985) 2 Comp LJ 208 (Ker). This decision was **affirmed** in *Sub-nom P.V. Chandran v. Malabar & Pioneer Hosiery P. Ltd.*, (1990) 69 Com Cases 164 (Ker—DB) and it was observed that the anxiety of a company to prefer a member for holding shares as against an outsider cannot be considered as unreasonable or arbitrary.

The articles of association of a private company provided: "Any person (not a member or the son/daughter or specified close relative of a member) becoming entitled to shares in consequence of the death of any member, shall, within 3 months..... offer the shares to members....." at their fair value. It was held that the executor of the will of a deceased member, who was himself registered as that person's nominee, became entitled to the legal interest in the shares and ought to be recognised by the company. Such an executor was within the exception contained in the parenthesis and was not bound to offer the shares to the members. The fact that he, on an assumption that he was bound by article 15, offered the shares to the members and the members had expressed a desire to pur-

chase them did not compel him to transfer the shares to the members who were willing to take them. His safer course would be to give notice to the company that he desired to transfer the shares and then make the company his agent for the sale of the shares at a fair value. *Victorine Roberts v. Letter "T" Estates Ltd.*, (1961) AC 795 : (1962) 32 Com Cases 80 (PC).

One of the requirements envisaged by the definition of a private company is that there must be some restriction upon transferability of the company's shares. It has all along been held by the courts that the restriction upon transfer means any restriction which will give some control to the company over transferability. It does not mean prohibitory restrictions. The Privy Council gave this ruling in *Ontario Jockey Club Ltd. v. Samuel McBride*, AIR 1928 PC 291. Their Lordships observed at p. 293 as follows: "That restrictions may be placed upon a shareholder's right of transfer of shares cannot be questioned. The cases are numerous in which such restrictions have been upheld. Shares are *prima facie* transferable. A restriction which precludes a shareholder altogether from transferring may be invalid but a restriction which does no more than give a right of pre-emption is valid." **Following** this ruling in *Chiranji Lal Jasrasaria v. Mahabir Dhelia*, AIR 1966 Assam 48 the Assam High Court held that the right of pre-emption does not amount to a prohibition upon transfer.

The proposition laid down in *Pool Shipping Co. Ltd., Re*, (1920) 1 Ch 251 was that where bonus shares are issued upon renounceable allotment letters and an allottee renounces in favour of another person, this does not amount to a transfer and accordingly is not subject to restrictions on transfer that may be contained in the articles. In its application to private companies which have necessarily to maintain a maximum limit of membership, this proposition would have to be as formulated by the Supreme Court in *Needle Industries India Ltd. v. Needle Industries Newey (India) Holding Ltd.*, (1981) 51 Com Cases 743 (SC) where it was suggested that right of renunciation under S. 81(1)(c) cannot apply to deemed public companies which have retained the characteristic of a private company because in that case if the shares are renounced in favour of a non-member that may result in a violation of the restriction as to the maximum number of members contained in S. 3(1)(iii). Though the Supreme Court was speaking in reference to deemed public companies, the principle laid down in the case would be applicable to all private limited companies.

By section 82 shares are expressed to be transferable in the manner provided by the articles of the company. There cannot be an absolute prohibition on the right to transfer shares. The right to transfer may be subjected to restrictions contained in the articles of a company. When a restriction is capable of two meanings the less restrictive meaning will be adopted by the court. *Delavenne v. Broadhurst*, (1931) 1 Ch 234; *Greenhalgh v. Mallard*, (1943) 2 All ER 234.

The case of *Lakshmi Natrajan v. Bharatan Publications Ltd.*, (1998) 94 Com Cases 367 : [(1997) 2 Comp LJ 243 : (1997) 25 CLA 96 (CLB—SB) showed that the member who was willing to transfer his shares gave notice to the company and the company gave notice to members indicating the intrinsic value of shares. Members made no firm offer, nor indicated the number of shares that they would purchase. Transfer to non-members was held to be justified. It was no objection that only intrinsic value was indicated and not the fair value.

Meaning of pre-emptive right

The articles of a private company restricted the members' right to transfer to non-members. In other words, transfer was allowed only in-between members. Explaining the meaning of the word "member" in this context the Company Law Board said that the definition of member for this purpose could not be stretched to persons who, without being members, were in the ultimate control of a member-company. The restriction upon the right to transfer shares to outsiders does not by itself operate as a pre-emptive clause. To create a pre-emptive clause, it is necessary to create a duty on the part of the seller

member to offer his shares by a designated mechanism to other members or a right-cum-duty on the part of the others to buy those shares. A simple restriction on transfer to outsiders will be operative only so long as some insiders are willing to buy at a fair price to be determined by directors. Where the articles do not lay down any procedure as to how exclusion of persons other than members is to be implemented, it would be the duty of directors to inform other members so as to make a reasonable effort for ascertaining whether any insider would be willing to buy at a fair price and only then to permit the shares to be transferred to outsiders. Where the directors registered a transfer in favour of an outsider without making reasonable effort to find an inside buyer, the transfer was set aside. *Cruickshank Co. P. Ltd. v. Stridewell Leather P. Ltd.*, (1996) 86 Com Cases 439 (CLB—New Delhi).

The case of *Cruickshank Co. Ltd. (supra)* was **followed** by the Company Law Board in *Satyanarayana Rathi v. Annamalaiar Textiles P. Ltd.*, (1999) 95 Com Cases 386 (1999) 1 Comp LJ 521 : (1999) 32 CLA 56 (CLB–SB). The articles of the company permitted transfer only in accordance with the articles. No shares could be transferred to an outsider if any member of the company was willing to purchase the shares at a fair price which had to be determined by the directors. Transfer to an outsider was possible only when the directors were unable to find a willing member-buyer. Two members filed affidavits expressing their willingness to buy the shares. This being the case, the question of registering the shares in the name of the pledgee did not arise. A transfer has to be in strict compliance with the articles of the company; otherwise, it is liable to be set aside. The company was bound to refuse registration of transfer in favour of the pledgee.

Private agreement for pre-emptive rights between shareholders does not bind company.—A private agreement between two shareholders which is not incorporated in the company's articles and by which they impose restrictions upon each other as to their right of transfer does not bind the company. The company can be compelled to register a transfer which satisfies other requirements though it is against the shareholders' private agreement. *Volvo Lastvagnar Komponenter AB v. Morgard Shammar India Ltd.*, (2000) 100 Com Cases 131 : (1998) 4 Comp LJ 112 (CLB—NB). Another case in which the court held that a private agreement between shareholders providing for pre-emptive rights and which was not incorporated in the company's articles does not bind the company is *Mafatlal Industries Ltd. v. Gujarat Gas Co. Ltd.*, (1998) 4 Comp LJ 112 : (1998) 30 CLA 167 : (1999) 97 Com Cases 301 (Guj). The court observed that so far as the transfer matters covered by section 111 and 111A are concerned, the Company Law Board has exclusive jurisdiction. But because the jurisdiction of civil courts is not barred, a civil suit can also lie, and, in view of the fact that free transferability of shares has to be assured, the extent of relief that the court should be able to provide would depend upon the facts of each case (*Ibid*). The Company Law Board can examine the entitlement of a person to the shares in question and his right to find a place in the register of members. A private agreement for pre-emptive rights which does not bind the company because the agreement has no place in the articles of the company can be the subject-matter of a civil suit between the parties to the agreement and the party committing breach may have to answer in damages to the other (*Ibid*). See *G. Venkatapathy v. Prakathi Spinners P. Ltd.*, (2002) 49 CLA 97 : (2002) 38 SCL 131 : 2002 CLC 1529 (CLB), where the requirement of the company's articles that a proposed *transfer should be intimated* to the directors who would give an opportunity to the existing members, was, in fact, complied with.

Shareholders private agreement as to transfer.—There was a clause in the company's articles requiring an executive director to transfer his share interest in the company on pro rata basis to subscribers or otherwise in accordance with the articles on termination of his employment with the company. Articles of association required members proposing to transfer shares to give *proper written notice to the company* authorising it to sell shares in accordance with the articles. The appointment of the executive director was unlawfully terminated. The question was whether the clause in the agreement had come into play. It was held that words in the relevant clause "for whatever reason" in the shareholders' agreement

would cover both lawful and unlawful termination and, therefore, the clause had come into operation. The shareholders' agreement was a contract between particular shareholders. There was no reason why a shareholder should not bind himself to operate a voluntary procedure for transferring shares if a particular contingency arose. The effect of the agreement on the whole was that an outgoing executive director was obliged to sell his entire share interest to the subscribers pro rate. *Holt v. Faulks,* (2000) 2 BCLC 616 (Ch. D).

Pre-emptive rights in listed companies.—A listed company refused to register a transfer of shares on the ground that the shares in question were subject to pre-emptive rights. This was held to be not a sufficient cause. Such shares have to carry a warning in writing on the share certificates about the existing rights. No such warning was there on the share certificates. No ground was thus available for refusal under S. 111 of the Companies Act, 1956 and S. 22A of the Securities Contracts (Regulation) Act, 1956. The company was directed to register the transfer *Pawan Gupta v. Hicks Thermometers (India) Ltd.,* (1999) 98 Com Cases 814 : (1999) 33 CLA 464 (CLB–NB). Defences of this kind and also that the transferee in question has been indulging in acts against the interests of the company are not entertainable under sections 111 and 111-A, Companies Act read with S. 22-A of the Securities Contracts (Regulation) Act, 1956. [*S. 22A Omitted w.e.f. 20-9-1995*].

Restrictions on right of a shareholder to transfer his shares generally take two common forms (1) Right of pre-emption in favour of the other members, (2) powers for the directors to refuse to register transfer.

1. Right of pre-emption.—The articles generally provide that when a member wishes to sell some or all of his shares, he shall first offer them to the other members at a price to be determined in the manner set out in the articles, and if the other members do not take up shares so offered, they may be sold to an outsider. An offer of shares made to the other members under the right of pre-emption is not irrevocable unless the articles so provide. If the articles do not provide that such an offer is irrevocable the member offering the shares can change his mind and decide not to sell to anyone so that the offer stands revoked when the other members or the company are notified to that effect. *Lyle and Scott Ltd. v. Scott's Trustees,* (1960) 30 Com Cases 30 : (1959) 2 All ER 661 (HL). No member is bound to sell his shares to other members under pre-emption clause unless the other members or some of them agree to buy all the shares which he offers for sale *Ocean Coal Co. Ltd. v. Powell Duffryn Steam Coal Co. Ltd.,* (1932) 2 Com Cases 454 : (1932) All ER Rep 844.

The articles of a private limited company often provide that the price payable for the shares sold in exercise of a right of pre-emption shall be a fair price to be certified by the company's auditor. In this regard it is stated in PENNINGTON'S COMPANY LAW, 817-818 (5th Edn., 1985) (p. 1006, 7th Edn., 1995) as follows: "If the pre-emption clause requires the shares to be offered to the other members at a fair value certified by the directors or the company's auditor, the court cannot enquire into the correctness of the valuation, unless there is evidence that it was not honestly made, or unless the person who made it set out the reasons for his valuation, and those reasons show that he did not apply the proper principles". *Dean v. Prince,* (1954) 24 Com Cases 198 : (1954) 1 All ER 749 (CA), *Burgess v. Purchase & Sons (Farms) Ltd.,* (1983) 2 All ER 4. This is so even if the person who made the valuation acted negligently by not taking relevant factors into account, by giving undue emphasis to one of those factors, or by taking irrelevant factors into account, *Baber v. Kenwood Manufacturing Co. Ltd. and Whinney Murray & Co.,* (1978) 1 Lloyd's Rep 175 and in that situation the transferor's only remedy is to sue the person who made the valuation for the difference between the valuation and the real value of the shares as damages in an action for negligence. *Arenson v. Casson Beckman, Rutley & Co.,* (1975) 3 All ER 901. However, where the error appears in the valuation itself, the fact that the company's articles provide that the valuation shall be final, binding and conclusive, or that the shares in question have already been registered by the company in the names of the other members who have exercised their pre-emption rights on the basis of

an erroneous valuation, does not prevent the members whose shares are the subject of the valuation from challenging its validity. *Burgess v. Purchase & Sons (Farms) Ltd.* (*Supra*). This statement from PENNINGTON was cited by the Bombay High Court in *Banoo J. Coyajee (Dr.) (Mrs.) v. Shanta Genevieve Pommeret Parulekar,* (1995) 84 Com Cases 534 (Bom) and acting on it the court held that sale of shares at a consideration worked out by a chartered accountant must be regarded as a fair transaction. The shares in question were first offered in accordance with the pre-emption clauses to the existing shareholders and one of them who accepted the offer was not afterwards able to pay the price. The shares were then sold to an outsider who acquired majority control over the company and using this power made a further issue of shares at face value and allotted them to the companies of his group in whose name the shares purchased were registered. This was not allowed to be questioned at the instance of the shareholder whom the share were first offered and who was not able to pay for them. The fact that the further issue of shares was at a nominal value was no reflection at the value at which the shares were transferred. The court cited the following statement from *Baber v. Kenwood Mfg. Co. Ltd. & Whinney Murray & Co.,* (1978) 1 Lloyd's Rep 175 at p. 179: "If two persons agree that the price of property should be fixed by a valuer on whom they agree, and he gives that valuation honestly and in good faith, they are bound by it. If there were fraud or collusion, of course, it would be very different. Fraud or collusion unravels everything."

In order to effectuate rights under pre-emption clauses the court can order the purchase of shares of the selling shareholders at a price to be based on principles of valuation laid down by the court. *Macro (Ipswich) Ltd., Re,* (1994) 2 BCLC 354 (Ch D); *Earliba Finance Co. Ltd.,* (1994) 2 BCLC 354 (Ch D); *Macro v. Thompson,* (1994) 2 BCLC 354 (Ch D). ARDEN J. said [at 410] that he would hear arguments on the point and then leave the matter with experts with a few guidelines, two of them being, (i) that 10% of the cost of repair in each of the year 1984-1994 should be included in the net assets valuation and that (ii) the goodwill should be apportioned between the outgoing shareholder and the continuing shareholder 65:35 respectively.

In the absence of restrictions in the articles the shareholder has by virtue of the statute the right to transfer his shares without the consent of anybody to any transferee, even though he be a man of straw, provided it is a *bona fide* transaction in the sense that it is an out and out disposal of the property without retaining any interests in the shares. *Delavene v. Broadhurst,* (1931) 1 Com Cases 414 : (1931) 1 Ch 234 (Ch D).

§ See also Notes under s. 3 under heading "Restriction on the right to transfer shares".

2. Power of refusal.—The power to refuse to register a transfer must be exercised by the directors in good faith and for the benefit of the company and not for some extraneous purpose. Consequently if the directors exercise this power in such a manner that the transferor cannot sell his shares at all or because they fear that the purchase by the intending transferee will prevent them from gaining control of the company, the court will order the company to register the transfer. *Robinson v. Chartered Bank of India,* (1865) LR 1 Eq 32; *Tett v. Phoenix Property and Investment Co. Ltd.,* 1984 BCLC 599. **Reversed** in 1986 BCLC 149 on the ground that the articles contained definite restriction on transfer which required notice of intended transfer to be given to the other members, and this requirement had not been complied with, the directors could not register the transfer.

The commonly accepted principle all-along has been that "the court will not interfere with the exercise by directors of a discretion not to register a transfer if their decision was one which a reasonable Board of directors could *bona fide* believe to be in the interests of the company." Per VINELOTT, J. in *Tett v. Phoenix Property and Investment Co. Ltd.,* 1984 BCLC 599 at 621 **reversed** on another point in 1986 BCLC 149.

The only provision in S. 111 about private companies is that contained in Sub-sec. (13) which is that nothing in Sections 111, 108, 109, 110 shall prejudice any power of a private company under its articles to enforce the restrictions contained therein against the right to transfer the shares of such company. The provision enables private companies to

refuse a transfer when it is violative of any restriction in the company's articles. A person who purchases the shares of a private company which has refused to accept him as a member can come before the Company Law Board for getting it decided whether the decision of the private company was an enforcement of the restriction contained in the company's articles or whether it was outside those restrictions or whether power was exercised in good faith in the interest of the company.

Section 111 before its amendment in 1988, was not applicable to a private company so long as it was not a subsidiary of a public company. However, in the case of a private company if transmission of shares took place by a sale thereof, held by Court or other public authority, the provisions of section 111 were applicable to such private company, as if it were a public company. The Company Law Board said [at p. 81]: "Sub-sections (4), (7) & (8) are primarily incorporating the provisions of section 155 of the Act as it existed before the amendment. There was nothing in section 155 to indicate that it is not applicable to private limited companies and litigation had been resorted to under that section with regard to rectification of the register, before High Courts. In clause 16 of the Amendment Bill, 1987 it is mentioned that the provisions of section 155 are being incorporated in section 111. Thus if section 155 was applicable to a private limited company, there is no reason why the present section 111 in particular, sub-sections (4) and (7) should not be applicable to a private limited company. There is no provision in the new section 111 declaring its inapplicability to private limited companies". *Jitendra Nath Saha (NRI) v. Shayamal Mondal,* (1995) 82 Com Cases 638 (CLB).

Rights of pre-emption and lending institution controlling transfer.—A lending institution granted loans on the condition that shares in the company would be transferred only with its permission. Rights of pre-emption were available to the directors and their family members. The lending institution permitted transfers in favour of third persons. Writ jurisdiction to prevent such transfers was held to be not available. The matters must be sorted out in a regular civil suit and evidenee must be available that either the lender's or company's interests would be prejudiced by such transfers. The lender was also not entitled to a declaration that transfer of shares without its permission was invalid. It could take that only as a breach of the conditions of the loan and act accordingly. *D. Sasidharan v. Sipcot,* (1992) 73 Com Cases 44 (Mad).

Rights of the lending institution to impose restriction on transfer of shares and assets.—Credit facilities were given to a company on the condition that the promoters would not alienate their shares on the company. The company entered into an agreement for divestment of 26 per cent. shares in favour of a foreign company. This created a possibility of a change in the composition of the Board of directors. The court said that this was *prima facie* contrary to the loan agreement with the bank. The bank was, accordingly, held to be entitled to an injunction to restrain the proposed transfer of shares as well as the immovable property mortgaged to the bank. The company was given the liberty to approach the bank for permission for transfer of shares. No injunction as to immovable property was issued. *Industrial Development Bank of India v. Rambal Ltd.,* (2003) 114 Com Cases 167 (Mad).

Approval of investment in shares by lending institution.—A company was allowed to take into account in refusing to accept a transfer of shares the fact that the share purchases of the transferee company had not been approved by the IDBI from whom the company borrowed money on terms, which included among others, that investment would be made with the approval of IDBI. *K.C.P. Ltd. v. EID Parry (India) Ltd.,* (1996) 87 Com Cases 361 (CLB).

Refusal on other grounds

Where it is *ultra vires* for transferee company to purchase shares.—In *Nava Bharat Ferro Alloys Ltd. v. Jeypore Sugar Company Ltd.,* (CLB Appeals Nos. 35 and 36 of 1980, dated 5-5-1982), a question arose whether transfer of shares in the name of a company could be refused on the ground that the company was not authorised by its object

clause to invest in the shares of another company. The CLB held that for a manufacturing or a commercial company the power to invest in shares *etc.* need not be under the head 'main objects' and the directors would be justified in making investment in the shares if such power is available under 'objects incidental or ancillary to the attainment of the main objects'. The Board concluded that investment of the company's surplus funds in the shares of other companies was fully covered by the appellant's object clause and hence it could not be held that the appellant had acquired those shares without any power in its objects clause.

Right of surviving joint holder to get registration.—Two brothers jointly held shares in a company. After the death of one, his wife applied for transfer of shares in her name after obtaining a succession certificate from the Court and because surviving joint holder disclaimed his interest in the shares, she was held entitled to be registered as a member by virtue of the transmission. *Kamla V. Pai (Smt.) v. Esso Standard Refining Co. of India Ltd.*, (CLB decisions, p. 66) : (1997) 3 Comp LJ 138 (CLB). Apart from such special situations it has been held that ordinarily only a surviving joint holder would be entitled to be registered on the death of his joint holder and the claim of the legal heirs to displace him would be rejected. *C.K. Sen & Co. (P) Ltd. Re,* (1998) 91 Com Cases 25 at 30 (CLB—Cal).

Cornering all shares through succession certificate.—In *Bina Barua v. Dalowjan Tea Co. Pvt. Ltd.*, (1981) 51 Com Cases 660, the articles of association provided that the heir of the deceased, where he was a sole or the sole surviving holder, shall be the only person to be recognised by the company. Under section 8 of the Hindu Succession Act, all the petitioners and their mother may be the heirs of the deceased, but the succession certificate was obtained only in the name of the first petitioner in respect of the entire 900 shares. It will not be consistent with the articles to allow all the shares to be registered in the name of petitioner alone; the fact that she is the guardian may not enable her to appropriate their shares. Under the circumstances, it could not be said that the directors had acted arbitrarily, capriciously or *mala fide* in refusing to register the transmission as prayed for by the first petitioner on the strength of the succession certificate. Had she applied for registration of the shares inherited by her alone in her name, the matter would have been different.

Succession certificate necessary in case of transmission.—The succession certificate is a necessary document to know the status of the person claiming to be the legal heir and the company's demand for production of succession certificate cannot be unreasonable or vexatious, *T.R. Sitaram v. Sitaram Anglo Ayurvedic Pharmacy Ltd.*, (CLB Appeal No. 47 of 1981, dated 31-7-1982); *Kasi Viswanathan Chettiar v. Petroleum Co. Ltd.*, (1936) 6 Com Cases 42, 46 (Rang). **Following** this in *Narinder Kumar Sehgal v. Leader Valves Ltd.*, (1993) 77 Com Cases 393 (CLB) it was held that where the deceased shareholder's will was filed by his five sons, a telegram from a daughter confused the issue as to the identity of the legal heirs and, therefore, the company was well within its powers to insist on the production of succession certificate or probate or letters of administration. Since one of the legal heirs was in possession of an item of the company's property, the directors could in the interest of the company offer to the legal heirs to consider the matter of transmission if they agreed as between themselves to a suitable distribution of the shares without reference to the issue relating to the property and this conduct of the directors was justified. The particular property was the subject-matter of a compromised decree in a suit by legal heirs.

In another allied matter, *Simret Katyal v. Bhagwandas & Co. P. Ltd.*, (1994) 1 Comp LJ 442 (CLB—Del) the CLB gave the ruling that proceedings for a succession certificate cannot forestall proceedings before the CLB for rectification of register of members and that where shares have descended by operation of law and there are apprehensions of alienation of the company's properties by those in possession, it would be inadvisable to stay proceedings for rectification of the register.

Where the succession certificate has been granted in respect of the shares, the company would not be justified in insisting upon the production of probate or letters of administration. *Thenappa Chettiar v. Indian Overseas Bank Ltd.,* (1943) 13 Com Cases 202 : AIR 1943 Mad 743 or to demand consent letters from other legal heirs. *S.M. Hajee Abdul Hye Sahib v. K.N.S. Hajee Shaik Abdul Kader Labbai Sahib Co. (P) Ltd.,* (1997) 26 Corpt LA 304 : (1997) 4 Comp LJ 117 (CLB—Mad). Where the articles require letters of administration to be produced and also enable the directors to dispense with the same, the directors may still insist upon the letters to be produced by the heirs of transferor. *Amraoti Electric Supply Co. v. R.S. Chandok,* (1954) 24 Com Cases 465, 470 : AIR 1954 Nag 293.

In *Sita Ram Tiwari v. Sukha Tea Co. Ltd.,* (CLB Appeal No. 3 of 1980, dated 31-10-1981), the appellant had produced the requisite succession certificate and was the rightful owner of the shares standing in the name of his father in the company's records. By virtue of articles of association of the respondent company, he was entitled to seek transmission of shares in his name. There was no order or decree of any court restraining the company from registering transmission of shares under appeal in the name of appellant. The same was the position in *Kamalabai v. Vithal Pd. Co. P. Ltd.,* (1993) 77 Com Cases 231 (Kar). The succession certificate showed the legal heirship of the aggrieved applicants for transmission and the court held that the company was bound to accept the same without the formalities of section 108 being complied with. The court further found that the two months' time which is available to the directors for refusing an application was allowed to pass without rejecting the application and that, therefore, they were no longer in a position to do so.

It has been held that a succession certificate was not necessary particularly where the parties were very close relatives showing that the petitioner was the rightful legal heir and also showing that he had a valid title to the shares. The CLB further held that even if succession proceedings are pending elsewhere, the CLB can examine the question of title. An instrument of transmission is not necessary. The company denied in this case that it had share scrips with it and said that they were with some-one else. The CLB felt that it was not an insurmountable problem. After due public notice, the company could issue duplicates. A mere statement by the company that sums were owing to it by the original member for which it had a lien over the shares was not sufficient. The company would have to substantiate it by evidence. *Simret Katyal v. Mahavir Ice Mills (P.) Ltd.,* (1995) 83 Com Cases 699 (CLB). Where the succession certificate was filed, the company was not allowed to insist upon the production of the original certificate because the company could issue duplicate certificates. *S.M. Hajee Abdul Hye Sahib v. K.M.S. Hajee Shaik Abdul Kader Labbai Sahib Co. (P) Ltd.,* (1998) 91 Com Cases 843 : (1997) 26 Corpt LA 304 : (1997) 4 Comp LJ 154 (CLB—Mad).

Regarding the provisions in the company's articles about members whose shares could be taken over by the company if they were carrying on a rival and competing business with the company the Company Law Board said that these provisions applied to existing members and could not be used to deprive the legal heirs of their legitimate right to get shares in transmission. If at all any such power was to be exercised, the petitioning legal heir should have been shown his legitimate position as a member in respect of the relevant number of shares and then told to choose between his membership and his personal rival business. The CLB most emphatically asserted the legal position that transmission cannot be refused on any ground whatsoever except non-production of requisite documents. *S.M. Hajee Abdul Hye Sahib's case (supra).*

Where the directors had the power under the articles to accept a transmission withou insisting upon a letters of probate, it was held that rejection of the application withou applying their mind to the discretionary power was wrong on their part and, therefor they were directed by the CLB to register the transmission. *Pushpa Vadora v. Thoma Cook (India) Ltd.,* ((1996) 87 Com Cases 921 (CLB—Bom). Where shares were left by deceased shareholder under his will and the will, as duly probated, covered the shares i

question, the CLB ordered registration of the shares in the name of the relatives but also added that they would be bound by the outcome of a civil suit for revocation of the probate which was pending at the material time. *Sanjeev Joy v. Pereiva and Roche (P) Ltd.*, (2002) 110 Com Cases 717 : (2002) 4 Comp LJ 482 : (2002) 38 SCL 203 (CLB). Where the deceased shareholder had left behind a will for transmission of his shares in his son's name, and the other legal heirs did not object, it was held that the company was not justified in calling for probate or letters of administration. *Khurshid Alam v. P. Pagnon Co. P. Ltd.*, (2002) 108 Com Cases 523 : (2001) 45 CLA 392 : (2002) 1 Comp LJ 175 (CLB—ER—Kolkata) : 2002 CLC 515.

A letter by the company to the legal heir of the deceased shareholder that he should approach the company for transmission only after obtaining succession certificate was held to be amounting to refusal enabling the legal heir to file an appeal against it. Where a succession certificate has been filed, it is not the concern of the company that proper court fee for the succession certificate was not paid. The company is not entitled to refuse transmission on that ground. A succession certificate in respect of shares held at the time of death would include bonus shares, dividend, interests and other benefits accrued up to date. A fresh certificate would not be necessary for such benefits. *Arjun Kumar Israni v. Cipla Ltd.*, (2000) 99 Com Cases 237 : (1999) 35 CLA 339 : (2000) 2 Comp LJ 136 : (CLB–WB).

Genuineness of consideration.—A company rejected transfer of shares on the ground that the consideration amount put in the transfer form at Rs. 150 per share as against the last transaction of Rs. 36 per share did not appear to be genuine. The Company Law Board held that the decision to refuse to register the transfer on that ground was wrong and hence liable to be set aside, *Dipak Kumar Jayantilal Shah v. Associated Pulp and Paper Mills Ltd.*, (CLB decisions, p. 169). Where a clause in a contract of sale of shares provides for the retransfer of shares at a fixed price below the actual value if the purchaser defaulted on payment, the clause was a penalty clause which could be sued upon but would not be enforced without giving the purchaser an opportunity to obtain relief. *Jobson v. Johnson*, (1989) 1 All ER 621 (CA).

Failure of consideration under a scheme under which share transfers were registered was held to be not a ground for asking rectification of the register of members. The CLB provided an alternative relief by protecting the selling shareholders against liability for the unpaid debts of the company. *Kamaraj (K.) v. Machimalai Tea Estates P. Ltd.*, (1995) 82 Com Cases 712 (CLB—SR).

The fact that less amount was entered in the consideration column of the transfer form than the market value of the shares, stamp duty being paid according to market value, was not allowed to be a ground on which a listed company could refuse the transfer. *Vikas Jalan v. Hyderabad Industries Ltd.*, (1997) 88 Com Cases 551 (CLB—SR).

Minor irregularities.—Irregularities of minor nature cannot be seized to defeat an otherwise valid transfer. Where the transferor of shares indicated an individual transferee, but the transfer form carried other names in addition to that individual, the company was not allowed to reject the transfer. Similarly, the discrepancy between the date indicated by the transferor and that shown on the transfer form was not allowed to be a ground for rejection. *Vikas Jalan v. Hyderabad Industries Ltd.*, (1997) 88 Com Cases 551 (CLB—SR). In *Asha Purandare v. Integrated Controls P. Ltd.*, (2002) 112 Com Cases 623 (CLB) : (2002) 49 CLA 378 : (2002) CLC 1315 : (2002) 39 SCL 970, a member intended to transfer all his shares. He served a transfer notice to the company as required by the articles. The notice carried a typographical error in specifying the number of one of the shares. The articles did not require the mentioning of detailed particulars of shares. The CLB said that the typographical error of the kind revealed in the notice in this case could not make the transfer notice invalid. Company's refusal to register the transfer was without sufficient cause. The company was directed to register the transfer in favour of the transferee.

Dispute as to title.—The respondent company refused to register the transfer of shares on the ground of disputed title of the appellant. A decree was awarded by sub-judge in favour of the appellant. In the light of the judgment of the court the appeal was accepted and the respondent company was directed to register transfer of the shares in the name of the appellant. *Amar Nath Berry v. Orissa Textile Mills Ltd.,* (CLB decisions, p. 28). When there was no dispute about the validity of the transfer deeds and the appellant had produced the share certificates along with the transfer form, the CLB directed that the transfer of shares should be registered by the company. *Abdul Tayabhhani Saheb Zakiuddin v. Belapur Sugar and Allied Industries Ltd. and another,* (CLB Appeal No. 19 of 1979, dated 11-12-1981).

Delay in presenting document.—In *S.K. Mukherjee v. American Refrigerator Co. Ltd.,* (CLB decisions, p. 58), the appellant purchased 500 equity shares by a transfer deed dated 11-11-1968. The transferor passed away after execution of the transfer deed. The respondent company's shares were quoted on stock exchange. Therefore, the transfer deed was to be presented on or before the first closing of register of members after 11-11-1968. The register of members was closed on 23-10-1969 and the appellant delivered the transfer deed to the company on 30-1-1969. The company refused to accept it on two grounds:

(i) the deed had not been filed according to the time allowed by section 108;

(ii) the appellant should take a 'no objection certificate' from the legal heirs of the deceased transferor.

It was held that on the first point, CLB had no power under S. 111 to give relief, particularly because the company had, in fact, filed an application before the Regional Director to whom the powers under section 108(1D) had been delegated. On the second point, CLB held that the transfer deed was not invalid on the ground that transferor was not living when the signature on behalf of the appellant-transferee was affixed on the deed and that there was no illegality in accepting the transfer deed.

Questioning validity of registered transfer.—The power to refuse cannot be exercised once a transfer has been recognised and registered. *Iron Traders (P.) Ltd. v. Hiralal Mithal,* (1962) 32 Com Cases 1022 : AIR 1962 Punj 277. In such cases the company should apply to the Company Law Board for an order of rectification. For further details see Notes under the heading "Power to repudiate registered transfer" *infra.*

Presumption of *bona fides*.—In the absence of evidence of circumstances to the contrary, the power will be presumed to have been exercised properly, *Charles Forte Investments Ltd. v. Amenda,* (1963) 2 All ER 940 : (1964) 34 Com Cases 233 (CA); *Mathew Michael v. Teekoy Rubbers (India) Ltd.,* (1983) 54 Com Cases 88 (Ker). **Affirmed** in *sub-nom* (1990) 69 Com Cases 145 (Ker—DB).

Directors in a state of dead-lock.—Where the directors, were unable to take a decision because of a dead-lock between them, it was held to be no refusal and, therefore, the company was bound to register the transfer. *Re, Hackney Pavilion Ltd.,* (1924) Ch 276. Where of the two directors, one refused to attend the meeting in order only to prevent the other from proceeding with the transfer, it was held that the transfer must be registered. *Re, Copal Varnish Co. Ltd.,* (1917) 2 Ch 349.

Irrelevant or inadequate reasons for refusal.—Where the Company Law Board finds the reasons as originally stated to be inadequate, the company is not allowed subsequently to supplement them. That would be in the nature of an afterthought. The Company Law Board did not approve the rejection of a transfer only on this ground that the shares were purchased at a very high price. *Karnataka Theatres Ltd. v. Venkatesan,* AIR 1996 Kant 18. Where there was no provision in the articles restricting transfers, the company was not permitted to refuse a transfer by one member to another or to the member's lineal dependants. *Cruickshank Co. P. Ltd. v. Stridewell Leather P. Ltd.,* (1996) 86 Com Cases 439 (CLB—New Delhi).

Rejection of transfer is not restrictive or unfair trade practice.—It has been held that the rejection of a transfer of shares by a company does not tantamount to either a restrictive or an unfair trade practice. It is so because no company carries on a trade of accepting or rejecting transfers. Furthermore, there is an elaborate appeal system within the framework of the Companies Act itself to take care of a wrongful rejection. Hence, a resort to other Acts is not necessary *Malhotra L. C. v. Ballarpur Industries Ltd.*, (1996) 8 SCL 50 (MRTPC).

Transfer of control inconsistant with company's objects.—A banking company was created for the advancement of a particular community and that object was specified in the objects clause of the company memorandum of association and it was also restated in the company's articles. The articles however empowered the directors to reject a transfer of shares only on two grounds: (a) that the shares were partly paid, and (b) that the company had lien on the shares. In this case the shares under transfer did not fall in any one of these categories. Nevertheless the directors refused to accept the transfer saying that the shares under transfer constituted 60% of the company's paid-up capital and the purchaser being a group of companies not belonging to the particular community, the very purpose of creating the banking company would be defeated and the directors could not be compelled to do anything which was against the company's objects. The CLB held that a new ground of rejection (other than those stated in the articles) could not be imported by linking the rejection with the objects of the company. *Hemangini Finance & Leasing P. Ltd. v. Tamilnad Mercantile Bank Ltd.*, (1996) 86 Com Cases 875 (CLB—Mad).

Transfer to a firm

The Companies Act does not contemplate the registration of the name of a firm as the holder of shares, but only Individuals or other entities. The refusal to register the name of transferee firm was held to be valid. *Ganesh Das Ram Gopal v. R.G. Cotton Mills Ltd.*, (1945) 15 Com Cases 32, 36 (Oudh). Shares can be transferred to a firm, in case of a Section 25 company.

Transfer in case of gift of shares

Under S. 123 of the Transfer of Property Act, 1882, a gift of shares, [a movable property], is effected by delivery of share certificate along with transfer deed duly executed by the donor. While the donee acquires a legal right to have the shares registered in his name, registration in the books of the company is necessary for the donee to acquire the status of a member.

For the purposes of an equitable assignment of shares by way of gift, delivery of the share transfer form, though required, could be dispensed with in some circumstances. In the instant case there had been a clear finding that the donor had intended to make an immediate gift. The donee had been informed of it, and it would have been unconscionable for the donor to have recalled the gift once the donee had signed the consent form. It followed that it would also have been unconscionable for her executors to refuse to hand over the share transfer to him after her death. In those circumstances, delivery of the share transfer before the donor's death was unnecessary so far as perfection of the gift was concerned. In any event, applying the principle that a benevolent construction should be given to words of gift in order to give effect to a donor's clear wishes. *Pennington v. Waine*, (2002) 2 BCLC 448 (CA).

§ See also Notes under S. 108 under heading "Transfer by way of gift".

Transfer of shares by or to nominee

§ See Notes under section 109A *ante*.

Transmission to nominee

§ See Notes under section 109B *ante*.

Advertisement of closure of register of members

Where a transfer was refused on the ground that the register of members had been closed for the time being but in fact there was no advertisement of such a closure, the refusal was held to be not valid. *Joseph Joseph v. Talyar Tea Co. Ltd.,* (1983) 2 Comp LJ 239 (CLB).

Effect of failure to intimate refusal within 2 months [(sub-section (1)]

Directors are under a duty to communicate the refusal to the applicant within the time provided by the section. This is necessary to enable the applicant, among other things, to exercise his right of appeal against the refusal. *Luxmi Tea Co. Ltd. v. Pradip Kumar Sarkar,* (1990) 67 Com Cases 518 (SC); *Debashish Dutta v. B.G. Somadder & Sons P. Ltd.,* (2002) 49 CLA 363 : (2002) 38 SCL 154 (CLB). What is intended under section 111 is to provide for a notice of refusal to be sent and that the failure thereof would entail penalty. The section does not specifically provide for the vesting of any right in favour of the transferee at the expiry of the period of two months. It is wrong to contend that the company loses its rights to refuse to register a share transfer on the expiry of the two months. *S.P. Mehta v. Calico Dyeing & Printing Mills Ltd.,* (1990) 67 Com Cases 533, 543, 544 (Bom). The decision of the Bombay High Court was **affirmed** by the Supreme Court in *Shailesh Prabhudas Mehta v. Calico Dyeing and Printing Mills Ltd.,* (1994) 80 Com Cases 64 (SC) accepting the view that the company does not lose the right of refusing to register a transfer or transmission by reason of its failure to exercise the power of refusal within two months.

However, the well-known general principle on this point is that decision to refuse must be taken within a reasonable time and on the face of things the two-month period allowed for sending the notice of refusal is the reasonable period to act. Failure to notify timeously will result in loss of power of refusal. *Swaldale Cleaners Ltd., Re,* (1968) 3 All ER 619 (CA), **followed** in *Inverdeck Ltd. Re,* (1998) BCC 256 : (1998) 7 CL 87. The transferee is not entitled to launch any proceedings within the two-month waiting period. *Zinotty Properties Ltd., Re,* 1984 BCLC 375 : (1984) 3 All ER 754. If the directors do nothing within the period of two months, their silence being not equivalent to refusal, it strengthens the transferee's rights and not only weakens any decision to refuse taken by the directors subsequently which may be rejected as an afterthought, but the directors also open themselves up for statutory penalties under this section. This should amount to the directors losing their right to reject and the transferee getting the right to claim rectification of the share transfer register. *Re, Hackney Pavilion Ltd.,* (1924) 1 Ch 276. The decision in *Swaldale* case, (*Supra*) was **distinguished** in *Popely v. Planarrive Ltd.,* (1997) 1 BCLC 8 (Ch D). Here the directors decided within time not to accept the transfer of a part of the shares but they did not inform the party within the prescribed period of two months. The court said that the principle stated in *Re, Swaldale Cleaners Ltd.,* was that if the directors failed to exercise their discretion within a reasonable time they lost their power to refuse registration. Different considerations would apply where the decision is taken within a reasonable time but there is a failure to inform the transferee of the decision. Such a failure may well expose the directors to civil or criminal liability but could not render the proper exercise of the directors' powers into a nullity. The decision in *Swaldale* case was **followed** in *Inverdeck Ltd.,* (1998) 2 BCLC 242 (Ch D) so as to emphasise again that the right of rejection if not exercised within two months would be lost. The applicant must then be registered. Whatever objections might have been there against the transfer in question, they could be subsequently considered in a separate proceeding.

Where an application for transfer could not be rejected within two months because during the whole of the relevant period there was only one director validly in office and the exceptional situations in which one-man meeting is valid were not applicable, it was held that the applicant had become entitled to seek rectification of the register of members. *New Cedos Engineering Co. Ltd., Re,* (1994) 1 BCLC 797 (Ch D).

Where the directors of a company allowed two months to pass without rejecting an application for transmission, it was held that they had lost the right of rejection, if at all they had any. *Kamalabai v. Vithal Pd. Co. P. Ltd.,* (1993) 77 Com Cases 231 (Kar). This decision should now be taken in the light of the Supreme Court decision in *Shailesh Prabhudas Mehta v. Calico Dyeing & Printing Mills Ltd.,* (1994) 80 Com Cases 64 (SC).

Who can file appeal [Sub-section (2)]

An appeal cannot be filed by a person who is neither a transferor nor a transferee. An appeal by a person who was only an inter-mediator in the transaction of sale of shares between transferor and transferee was not allowed. *Vinod K. Patel v. Industrial Finance Corpn. of India Ltd.,* (1999) 21 SCL 181: (1999) 3 Comp LJ 215 : (2000) 36 CLA 412 : (2001) 103 Com Cases 557 (Del).

Limitation for filing appeals against refusal and condonation of delay [Sub-s. (3)]

An appeal against refusal to register transfer of shares must be preferred within two months from the date of refusal otherwise it would be barred by the law of limitation. *Metal Press Works Ltd. v. Ram Pratap Kayan,* (1967-68) 72 CWN 594 at 600 (Cal).

The appellate powers under section 111 against refusal to transfer shares were earlier exercised by the Company Law Board as a delegatee of the Central Government, when the delay in filing the appeal could be condoned under clause (a) of Section 637-B. After the amendment of section 111 by the Amendment Act of 1988 w.e.f. 31-5-1991, the power has been statutorily conferred on the CLB. The Board has now no power to entertain an appeal beyond the statutory period laid down in sub-section (3). Similar is the position of a reference made under section 22A(4)(c) of the Securities Contracts (Regulation) Act, 1956 whereunder the reference can be made to the CLB before the expiry of two months from the date on which instrument of transfer is lodged. Under Section 5 of the Limitation Act, 1963 any appeal or application, may be admitted after the prescribed period if the appellant or the applicant satisfies the Court that he had sufficient cause for not preferring the appeal or make the application within such period. In *Carbon Corporation Limited, Re,* (1992) 73 Com Cases 572, 581-82 (CLB), it was held by the CLB that it has no power to extend time for filing the reference and condone the delay because CLB, being not a court the Limitation Act is not applicable.

A case came before the Company Law Board in which the company intimated the refusal after two years. Two months period from that day became available for preferring an appeal. If the company had not intimated the refusal, the maximum time would have been four months from the date of lodgement and that would have expired long ago. The natural effect of the decision is that the period of limitation is linked with the company's conduct. If it does not refuse formally and let time run out, only four months are available, and, if it refuses formally after any length of time, two months would be available from the date of intimation of refusal. *Vimal K. Gupta v. Auto Lamps Ltd.,* (1996) 86 Com Cases 157 (CLB—NR).

An appeal was forwarded within the period of two months but received by the CLB a little late. The party asked for condonation of delay by the CLB by exercising its power under section 637B as a delegatee of the Central Government. The Board condoned the delay on cogent reasons. This kind of exercise of discretion was not permitted to be interfered with under writ jurisdiction. Section 637B applies to applications. The Board said that section 111 contemplates appeals to the CLB and an application for condonation would have the effect of an appeal. *Karnataka Theatres Ltd. v. Venkatesan,* AIR 1996 Kant 18 : (1998) 93 Com Cases 433.

Where the petition was filed after a delay of 17 years during which the petitioner might have pursued some alternative remedies but the same were not disclosed in the petition, it was held that the petition was not maintainable. *Abani Bhushan Bhattacharya v. Ericsson India P. Ltd.,* (1998) 93 Com Cases 939 : (1998) 30 CLA 107 : (1998) 3 Comp LJ 351 (CLB—NB).

The High Court has the power to condone delay by using S. 5 of the Limitation Act, 1963, but not the CLB. The High Court, in an appeal against the decision of the CLB, held that the CLB enjoyed that power and remanded the case to the CLB for consideration whether sufficient cause for condonation of delay existed. The CLB considered the matter again and found sufficient cause for condonation of delay because the aggrieved applicant after taking the refusal kept trying to persuade the directors to accept the transfer and as soon as he realised his failure, he lost no time in approaching the CLB. The CLB considered the merits of the matter, passed an order directing the company to register the transfer within 30 days from the receipt of the order. *V.K. Gupta v. Auto Lamps Ltd.*, (1999) 96 Com Cases 555 : (1999) 33 CLA 117 : (1999) 20 SCL 1 : (1999) 2 Comp LJ 519 (CLB—NB).

Conditional refusal and limitation.—Where after a protracted correspondence the company ultimately refused to register a transfer unless a condition was fulfilled, it was held that the period of two months started running from the date of the receipt of the letter of conditional refusal. *Pushpa Vadhera v. Thomas Cook (India) Ltd.*, (1996) 87 Com Cases 921 (CLB). The period of two months, where transfer documents have been returned for rectification, would start running from the date on which the documents are relodged after removing the legal infirmities. *Vasant Investment Corpn. v. CLB*, (1999) 33 CLA 265 : AIR 1999 Bom 207 : (1999) 19 SCL 499 : (2000) 6 Comp LJ 418 (Bom).

Forged transfer and limitation.—Where the petitioner was alleging that his shares had been transferred fraudulenty on the basis of forged signatures and fraudulent attestation of the same and thus the transfer was void *ab initio*, it was held that in such a case the period of limitation could not be strictly applied. *Bhuwaneshwar Nath Nigam v. Hindustan Lever Ltd.*, (2002) 111 Com Cases 590 : (2002) 49 CLA 85 : (2002) 38 SCL 124. See also *Calcutta Security Printers Ltd. v. Calcutta Phototype Co. Ltd.*, (2002) 112 Com Cases 434 (CLB) : (2002) 38 SCL 544, where also the CLB remarked that where forgery is alleged, the question of limitation is to be viewed liberally. The registration of transfer was found to be fraudulent and based on forgery.

Sections 155 and 156 omitted by Amendment Act, 1988

The powers of the Court to rectify the register of members of a company in case name of any person was without sufficient cause entered in the register or after having been entered in the register was, without sufficient cause, omitted therefrom, as contained in section 155 has now been vested in the CLB. The provisions of section 155 are now included in sub-section (4) of the recast section 111. Excepting the transfer of jurisdiction, the scope of the erstwhile section 155 on its merger with section 111, almost continues to be the same as merged in S. 111. The commentary and case laws under the omitted section 155 are detailed hereunder.

Res judicata

The doctrine of *res judicata* would not come into play when an application challenging refusal of a transfer is permitted to be withdrawn without considering it on merits. *Bank of Maharashtra v. Sangli Bank Ltd.*, (1992) 73 Com Cases 125 (CLB).

Rectification of Register [Sub-sec. (4)]

The word 'rectification' means that there is either something in the register which should not be there or something omitted from the register which should rightly be there, and the register is accordingly ordered to be rectified. *Ward and Henry's* case, *In Re, London Hamburgh and Continental Exchange Bank*, (1867) LR 2 Ch App 431. See also *Benarsi Das Saraf v. Dalmia Dadri Cement Ltd.*, (1958) 28 Com Cases 435 : AIR 1959 Punj 232; *Kaithal Cotton and General Mills Co. Ltd. v. Pioneer and Co.*, (1961) 31 Com Cases 138 (Punj); *Mohd. Akbar v. OL*, (1950) 20 Com Cases 26, 30 : AIR 1950 Bom 386. Where something is done by the operation of law or in accordance with the directions of the Court, there is no question of any wrong or defect which requires rectification. *Benarsidas Saraf v. Dalmia Dadri Cement Ltd.*, (*Supra*). Where the facts showed proper exe-

cution of transfer forms, attestation of signatures, surrender of share certificates and payment of consideration through bank, rectification was held to be not allowable without proving that the facts on record were wrong. *Muniyamma v. Aarthi, Cine Enterprises P. Ltd.,* (1991) 72 Com Cases 555 (Kar). On appeal the order of the single Judge was **reversed**. The transfer of the shares alleged to have been made by the petitioners was declared as invalid on the technical ground that transfer forms though stamped, the stamps were not cancelled and, therefore, they had to be treated as unstamped. The petitioners were accordingly declared to be continuing as the members of the company. Some others who had similarly transferred shares and who were not a party to the petition, the Court passed no order in reference to them. *Muniyamma v. Arathi Cine Enterprises P. Ltd.,* (1993) 77 Com Cases 97 (Kar–DB).

Those who were present at the meeting which approved a transfer, were not afterwards permitted to challenge the validity of the transfer. *Mukundlal Manchanda v. Prakash Roadlines Ltd.,* (1991) 72 Com Cases 575 (Kar). The challenge in this case was on the ground that the shares transferred by the transferor were part of the petitioner's *stridhan* property and therefore the transferor did not have the power of disposal without her consent. The case arose under s. 155 before its absorption into s. 111 and the courts then usually refused to look into such extraneous matters. This judgment of the single judge was **affirmed** in *Suresh Kumar Manchanda v. Prakash Roadlines Ltd.,* (1996) 87 Com Cases 102 (Kant—DB). The court counted the factors that may disentitle a petitioner from relief, namely, suppression of material facts, acquiescence, delay, laches, *etc.* Apart from delay, there was also acquiescence in this case because petitioners participated in meetings which were attended by transferee and it would seem that the transfer under question had been taken as an accomplished fact. This fact was suppressed by the petitioner. All there factors put together disentitled the petitioner from seeking relief of rectification. In another case involving similar facts the transfer of shares in a public company made ten years earlier with the approval of the Board was not allowed to be questioned when the persons objecting did not do so in the relevant meeting of the Board and the transferees since then had been enjoying all the legal rights and benefits arising from those shares. *Milan Sen v. Guardian Plastics Ltd.,* (1998) 91 Com Cases 105 (Cal).

Earlier to repeal of s. 155 and its re-enactment in s. 111(4) it was held that the power of the court under the section was untrammelled by section 111. The transferee might seek relief either under section 111 or under section 155 (Now S. 111(4)). *South Indian Bank Ltd. v. Joseph Michael,* (1978) 48 Com Cases 368 (Ker–DB). The Court could not determine the beneficial ownership of shares in proceedings under Section 155 (Now S. 111(4)). *Mahabir Singh v. Jaisingh,* (1978) 48 Com Cases 558 (Delhi). The section gives unlimited jurisdiction to the Court to rectify the register. In all cases where justice requires it, the order to rectify will be made *nunc pro tunc, Re, Sussex Brick Co.,* (1904) 1 Ch 598; *Re, Imperial Chemical Industries Ltd.,* (1936) 2 All ER 463 (Ch D).

Acting under the power of the Articles of Association which declared that, if the transferee is a proper person the share will be transferred to the name of the transferee, the Company declined to register the transfer of a share. The transferee of the share applied to the Court for rectification of the register of shares by having his name substituted for that of his transferor.

The court allowing the claim, held that it had jurisdiction to decide, even without reference to the directors or the company, whether the transferee had a right under the Article to get his name registered or not and for that purpose to determine whether he was a proper person. *Rajnagar Spg., Wvg., and Mfg. Co. Ltd. v. Manilal,* (1912) 14 Bom LR 919 (Bom).

Aggrieved person

The expression "aggrieved person" would include a transferor of shares who had handed over the transfer documents to the transferee who lodged them with the company and the same were rejected by the company as bad delivery (signature of transferor not

agreeing). *S.V. Nagrajan v. Lakshmi Vilas Bank Ltd.*, (1997) 90 Com Cases 392 : (1997) 4 Comp LJ 112 (CLB). Before the merger of S. 155 into S. 111 as sub-s (4) under the 1956 Act and also under 1913 Act, an appeal lay to the High Court against an order of a District Judge rejecting an application for rectification of the register of members. *Amrita Lal Ghose v. Sirish Chander*, (1899-90) 4 CWN 101 (Cal).

Specific instances of rectification.—Rectification has been held to be permissible in the following cases:

(a) applicant induced to take shares by misrepresentation; *Stewart's* case, (1866) 1 Ch 574; *Asher's* case, (1874) 9 Ch 664; *Yamuna Das Kanojea v. Behar Engineers & Contractors Ltd.*, (1944) 14 Com Cases 163 (Pat);

(b) shareholders' name removed under unlawful surrender of his shares, *Bellerby v. Rowland & Marwood's Steamship Co. Ltd.*, (1902) 2 Ch 14;

(c) allotment of shares before consent under the Capital Issues (Control) Act, 1947, *Industrial Development Bank of India v. B. Ananthaswami*, (1986) 60 Com Cases 99 (Mad);

(d) allotment irregular, *Homer Dist. Cons. Gold Mines, Re*, (1888) 39 Ch D 546;

(e) allotment in violation of articles made by two directors in favour of their relatives without the sanction of the Board only for the purpose of increasing the majority of the directors, *Basudeb Kataruka v. Dhanbad Automobiles P. Ltd.*, (1977) 47 Com Cases 68 (Pat); *Amrit Kaur Puri v. Kapurthala Flour Oil & General Mills Co. P. Ltd.* (1984) 56 Com Cases 194 (P&H);

(f) name of nominee entered in register without his knowledge or consent, *Hercules' Insurance Co., Re*, (1872) 41 LJ Ch 580;

(g) a forged transfer acted upon, *Bahia & San Francico Rly. Co., Re*, (1868) LR 3 QB 584; *Peoples' Insurance Co. Ltd. v. CRE Wood & Co. Ltd.*, (1961) 31 Com Cases 61 : AIR 1960 Punj 338;

(h) applicant's name improperly entered in register and then struck off on forfeiture of shares. *In Re, Bank of Hindustan, China & Japan, Re*, (1865) 34 LJ Ch 609;

(i) invalid forfeiture of shares, *Public Passenger Service Ltd. v. M.A. Khadar*, AIR 1962 Mad 276. **Affirmed** by Supreme Court in (1966) 36 Com Cases 1 : AIR 1966 SC 489: *Kotah Transport v. State of Rajasthan*, (1967) 37 Com Cases 288 : AIR 1966 Raj 136 (DB);

(j) illegal discount issue, *Oregum Gold Mining Co. of India v. Ropar*, (1892) AC 125 (HL); *Famatina Development Corpn. Ltd. v. Bury*, (1910) AC 439 (HL);

(k) improper neglect or unreasonable delay in registering transfer, *Re, Stranton Iron and Steel Co.*, (1873) LR 16 Eq 559;

(l) accepting payment for shares in kind without filing particulars in compliance with S. 75(1)(b), *Re, New Zealand Kapanga, etc., Co.*, (1873) 18 LR Eq 17;

(m) placing on the register signatory of an underwriting letter not amounting to a contract, *Re, Consort, etc., Mines*, (1897) 1 Ch 575;

(n) allotment not made within reasonable time, *Re, Bowron, Baily & Co., ex p. Baily*, (1868) 3 Ch App 592;

(o) joint holders seeking to split the holding into individual holding; *Burns v. Siemens Bros Dynamo Works Ltd.*, (1919) 1 Ch 225;

(p) company's register showing matters which are not required to be there, *Re, W. Key & Sons Ltd.*, (1902) 1 Ch 467; *Re, T H Saunders & Co. Ltd.*, (1908) 1 Ch 415;

(q) allotting shares to a non-resident without permission necessary for foreign exchange, *Re, Transatlantic Life Assurance Co. Ltd.*, (1979) 3 All ER 352;

(r) improper or illegal refusal to accept a transmission, ***Hemendra Prasad Barooah v. Bahadur Tea Co. Ltd.***, (1991) 70 Com Cases 792, 796 (Gau); *State of Orissa v. Indian Chemical Products Ltd.*, AIR 1957 Ori 203; *Kamalabai (Smt.) v. Vithal Prasad Co. P. Ltd.*, (1993) 77 Com Cases 231, 243 (Kar); *Indian Chemical Products Ltd. v. State of Orissa*, (1966) 36 Com Cases 592 : AIR 1967 SC 253;

(s) entering a person's name in the register without agreement in writing as required by S. 41. *Ramkishan v. Kanwar Papers (P.) Ltd.*, (1990) 69 Com Cases 209, 220 (HP);

(t) entering a person's name in the register in respect of certain shares without any transfer form and also without any consideration; the original owner's name was ordered to be restored, *International Credit and Investment Co. (Overseas) Ltd. v. Adham*, (1994) BCLC 66 (Ch D);

(u) when the CLB records the finding that the requirements of s. 22A of SCRA 1956 [*Since Omitted*] were not violated by the proposed transfer, the CLB would have to order rectification. *Shoe Specialities Ltd. v. Tracstar Investments Ltd.*, (1997) 88 Com Cases 471 (Mad—DB);

(v) allotment of bonus shares and entry in the register when subsequently it was discovered that the memorandum of the company prohibited dividend to be paid out to surplus realised on sale of property and there was no other allocable profit. *Cleveland Trust Plc., Re*, 1991 BCLC 424 (Ch D).

(w) Allotment in violation of memorandum. *M.V. Sathayanarayana v. Global Drugs P. Ltd.*, (1999) 95 Com Cases 595 : (1999) 32 CLA 148 (CLB—SB). The court **followed** *Bhupinder Rai v. S.M. Kannappa Automobiles P. Ltd.*, (1996) 86 Com Cases 18 : (1999) 1 Comp LJ 507 (CLB—SB); *Volvo Lastvagnar Komponenter AB v. Morgard Shammar India Ltd.*, (2000) 100 Com Cases 13 : (1998) 4 Comp LJ 112 : (1998) 30 CLA 382 (CLB—NB).

Mutation of name in other Company's register of members.—The company which has changed its name would be entitled to ask those companies in which it is holding shares to substitute a company's new name in their register of members in place of the old name. *Sulphur Dyes v. Hickson & Dadajee Ltd.*, (1995) 83 Com Cases 533 (Bom).

Rectification in winding up.—The jurisdiction can be exercised whether before or after the winding up, though after an order of winding up has been made, the leave of the Court will be necessary for an application (section 446), and the order, if made, may be made retrospective; *Surendra Prakash Goel v. Goel Industries Pvt. Ltd.*, 1980 Tax LR 2007 (All). See also *Bank of Hindustan Ltd. v. Kowtha Suryanarayana Rao*, (1958) 28 Com Cases 71 : AIR 1957 Mad 702. But an application for rectification after winding up will be refused, if made after long unexplained delay, even though the case may be a proper one for rectification. *T.V. Somasundaram Pillai v. Official Liquidator*, (1967) 37 Com Cases 440 (Mad).

Rectification will not be permissible after a winding up order is made and rights of third parties have come into existence. *V. Rajagopal v. Salem Provident Society Ltd.*, (1963) 33 Com Cases 435, 443 (Mad) (case law discussed). See also *T.V. Somasundaram Pillai v. Official Liquidator*, (1967) 37 Com Cases 440 (Mad). The Court referred to an earlier decision of the Division Bench of the Madras High Court where it was held that a petition for rectification could lie after filing a winding up petition and before the winding up order is passed. The Division Bench also held that the court will normally reject the petition if the company is already in a notorious state of bankruptcy. *Bank of Hindustan v. Suryanarayana Rao*, (1958) 28 Com Cases 71, 87 : AIR 1957 Mad 702 (DB). The Division Bench of the Bombay High Court has held that rectification of register is permissible after the company has gone into liquidation if the application for transfer of shares was made before the winding up order but there is delay or default on the part of the company in dealing with the application. *Indian Specie Bank Ltd. v. Patvardhan*, AIR

1915 Bom 1 (DB); see also *Darjeeling Bank Ltd., Re,* (1960) 30 Com Cases 50 : AIR 1959 Cal 335.

A liquidator, however, may apply, and there will be no question of delay in his case; as the cause of action for his application will arise only on the making of the order for winding up. *K. P. Shankar, Official Liquidator v. Sardar Haridhan Singh,* (1966) 36 Com Cases 209 (Punj–DB).

Shares allotted by mistake to minor

Department's Clarification.—In a case where shares were allocated by mistake to minor and the company has no power under its articles to do so, the proper course of action would be to rectify the register of members after approaching the Court (now the CLB) under this section. [*Letter No:* 8/16/(1)61-PR, dated 9-5-1961].

Rectification of mistaken entries

The plaintiff contended that he was the real owner of the shares which were entered in the company's register of members in the names of others. He wanted a declaration that the shares belonged to him and that the register of members be rectified by replacing those names with his name. It was held that such a claim was not maintainable. There was no question of declaration. If the entries in question were proved to be wrongful, rectification would automatically follow. *Eternit Everest Ltd. v. Neelamani Bhartiya,* (1999) 2 Comp LJ 171 : (1999) 34 CLA 136 : (1999) 20 SCL 407 (Raj).

Where name of HUF or partnership firm or a proprietorship concern is entered by mistake in the register of members of a company, the mistake can be rectified by the directors on being satisfied as to the facts without the necessity of executing a transfer deed. The intervention of CLB will be necessary only where the directors refuse to rectify the register of members on sufficient cause shown.

Original share certificate returned to transferor by mistake.—Where in the office of the company the transfer deed became separated from the share certificate and the company by mistake returned the original share certificate comprising half the number of shares under transfer to the original owner who transferred them again and the subsequent transferee having agreed to receive compensation for his loss in respect of those shares, the CLB ordered that the original owner be directed to pay the agreed amount to the frustrated buyer and the duplicate share certificate which was prepared for him but not issued be destroyed. *Chambal Fertilizers and Chemicals Ltd. v. Kore Ranga Babu,* (1996) 86 Com Cases 545 (CLB—NR); *Chambal Fertilizers and Chemicals Ltd. v. Bukka Ramulu,* (1996) 1 Comp LJ 538 (CLB— NR). Where by the mistake of a company, in respect of the same set of shares two certificates came into being and issued, the company was held liable to compensate the person who *bona fide* purchased the shares of the company on the basis of any one of the two sets. *Chambal Fertilizers and Chemicals Ltd. v. A. Venkatareddy,* (1996) 86 Com Cases 145 (CLB—NR).

Employees' quota, allotted to outsiders.—The quota of shares reserved for employees was by mistake allotted to outsiders and entered in the register of members. On realising the mistake the company applied to the CLB for an order authorising it to reverse the allotment in favour of outsiders. The Board ascertained the views of the Securities and Exchange Board of India (SEBI) and authorised the reversal. The company was told to work out the modalities for recovering share certificates from the original allottees, but that if recovery could not be effected from some of them, the allotment to them was not to be cancelled or forfeited because that would amount to reduction of capital. *Polar Latex Ltd. v. Lakshmi Narayan Rez,* (1996) 85 Com Cases 766 (CLB—ER).

Company's duty to maintain register up-to-date

It is the duty of the company to maintain its register of members with up-to-date information posted in it. The company will not be allowed to take any unfair advantage of its dereliction of duty in this respect. Thus in a petition for prevention of oppression and

mismanagement the shareholders to whom share certificates had been issued but whose names were not figuring in the register were held to be competent to file the petition. *N. Satya Prasad Rao v. V.N.L. Sastry,* (1988) 64 Com Cases 492 (AP). The responsibility within the infrastructure of the company for maintaining the register and keeping it posted is a matter to be dealt with by the company's articles. Thus where under the articles of a club registered as a company the membership was restricted to 1,500 members which could, however, be increased by the "general committee", it was held that it was not proper for the directors to have increased the number of their own accord and to have the new members' names entered in the register and that, therefore, a petition for rectification of the register by deleting such names was maintainable but the petition was not allowed to go further unless all those persons whose names had to be removed were also joined as parties. *Dharam Pal Bhasin v. B.N. Khanna,* (1988) 64 Com Cases 651 (Del).

Alternative remedy

If a party has two remedies *i.e.*, filing a suit for specific performance or a petition under section 155, [*now S. 111(4)*] it is open to the party to choose any one of such remedies. The remedy under this section is equally efficacious, definitely more speedy and certainly appropriate. *Shanta Genevieve Pommeret v. Sakal Papers (Pvt.) Ltd.,* (1990) 69 Com Cases 65, 83 (Bom).

Transfer sub-judice.—Where the matter of the transfer of shares is pending in a civil court and is being hotly pursued by both parties, it would not be desirable or expedient to order registration of the transfer of such shares. In this case, there were four groups of shareholders in the company. The case involved transfer of shares by one of the groups to another group. The groups were not of stable nature. There were realignments from time to time, ultimately resulting in litigation between them. The court would not do anything to disturb management on the basis of unrecorded majority. The present management was not to be disturbed because the financial condition of the company was satisfactory. The court directed the company to constitute the Board of directors in a certain manner pending disposal of proceedings in suits and petitions. *Rattan Chand Jain v. Uberoi Ltd.,* AIR 1996 Del 117 : (1998) 93 Com Cases 906 : (1996) 1 Comp LJ 541.

While it is convenient not to register transfers the validity of which is the subject-matter of civil litigation, there is no illegality in granting registration to such transfers unless the court has issued a stay order. *Vikas Jalan v. Hyderabad Industries Ltd.,* (1997) 88 Com Cases 551 (CLB).

The Company Law Board should not mechanically reject a petition because of some pendency of the same matter before a civil court. The matter should be disposed off after due consideraiton on the basis of affidavits as filed. *Nupur Mitra v. Basubani (P.) Ltd.,* (1999) 35 CLA 97 (Cal).

Pending petition against oppression

The pendency of a petition under s. 397 for relief against oppression is not a ground for staying an application for rectification of the company's register of members. The petitioner's name was dropped from the register by substituting it with another person's name without sufficient cause and he was seeking restoration of his name. *Anand Hemant Patel v. Ornate Club (P.) Ltd.,* (2000) 99 Com Cases 318 : (2000) 36 CLA 6 (CLB–WB).

Scope and limits of jurisdiction: Jurisdiction confined to entries in register

It may be noted that the jurisdiction to rectify, though very wide, is confined to matters pertaining to entries in the register. There is no jurisdiction to rectify any mistake in the articles of association of a company on any ground even where they do not accord with the intention of the subscribers. *Scott v. Frank F. Scot (London) Ltd.,* (1940) 3 All ER 508.

An allotment cannot be set aside only on the ground that the newly created shares were issued at their face value when the intrinsic value of the shares was higher than that. *Mani (M.S.) v. M.S. Madhusoodanan,* (1991) 5 Corpt LA 187 (Ker—DB).

Only the rights and liabilities arising under the provisions of the Companies Act can be inquired into in a petition under this section. The legality or validity of a trust created by a company and the position of the Public Trustee under Section 187-A and Section 187-B, if questioned, will have to be determined only by a suit in the Civil Court. See *Public Trustee v. Rajeshwar Tyagi,* (1973) 43 Com Cases 371 (Del—DB).

The validity of a will under which ownership of the shares and rectification of the register are claimed, cannot be examined under the jurisdiction conferred by section 111(4). *Kamla Devi Mantri v. Grasim Industries Ltd.,* (1990) 69 Com Cases 188 (MP).

In the case of a society registered under the Companies Act, the company judge appointed a committee for ascertaining who the members of the company were for the purpose of holding the next meeting of shareholders. In appeal, the Division Bench held that the finding of the committee would have no legal sanction. When there is an express provision empowering the court to rectify the register, only the court has power to act under the section. The exercise of power of this kind cannot be left to a committee. There is no purpose in the court trying to rectify the register of members on its own initiative by a procedure not laid down by the section. *Dinekar Rai D. Desai v. R.P. Bhasin,* (1986) 60 Com Cases 14 (Del).

The court cannot in a petition under this section at the instance of the transferee enter into an enquiry as to the validity of an amendment to the articles especially when a suit by the transferor making such challenge would have been barred by limitation. *Joseph Michael v. Travancore Rubber & Tea Co. Ltd.,* (1986) 59 Com Cases 898 (Ker).

In *Harish Ratilal Shah v. Vikrant Tyres Ltd.,* (1982) 52 Com Cases 125 (Karn), it was held that when the name of the shareholder had already been deleted and the shares forfeited, the Court would not enquire into the reasons for which the name was deleted and would not entertain a petition for rectification of the register of members.

The court in exercising jurisdiction under this section cannot partition shares because (1) there is no definite knowledge as to the extent of the estate of the deceased and of what properties would fall to the shares of the heirs and (2) the company court cannot be vested with the powers to divide and allot shares even if the shares were the only property of the deceased. *Hemlata Saha v. Stadmed (P.) Ltd.,* (1964) 34 Com Cases 875 : AIR 1965 Cal 436. See also *In re, New Monkhooshi Tea Co. Ltd.,* AIR 1967 Cal 196. See further, *Kalyani Sundaram v. Shardlow India Ltd.,* (1990) 67 Com Cases 306 (Mad), where it was also added that the validity of the transfers effected by the administrator of a family in order to enable him to pay-off the debts of the deceased cannot be questioned under this section; *Kamla Devi Mantri v. Grasim Industries Ltd.,* (1990) 69 Com Cases 188 (MP), where the "will", under which the transfers were allegedly effected, was questioned on the grounds of fraud, misrepresentation and undue influence, and the court said that such questions cannot be decided under this section.

In a case before the Allahabad High Court, the court doubted the propriety if not the legality of the learned District Judge's attitude while sitting as a Company Judge in involving himself in bargains and counter-bargains between the directors of the company and the person applying before him for the rectification of the register of members. Under s. 155 [now s. 111(4)] the learned Judge either should refuse to rectify the register or should grant the prayer for rectification of the register. The provisions of that section do not contemplate that he could pass any other kind of order. That being the position even if it be conceded that the learned Judge could give force to a compromise or any arrangement between the parties then that arrangement must be within the scope of that section. There is no justification in the order of the District Judge to compel the appellant to sell or transfer the shares. Such an order being beyond the scope of s. 155 [now s. 111(4)] any compromise to that effect could also not be recorded even if the District

Judge as a Company Judge had such powers to record a compromise. *Ram Chandra Gupta v. Kanpur Iron Scrap Merchants Assn. Ltd.*, AIR 1964 All 45 at 46.

'Any person having become a member' [Sub-section (4)(b)].—The words "the fact of any person having become a member" as used in the section have been construed to mean "having become entitled to be a member" or "having got the right of membership". *Nazamunnessa Begum v. Vidyasagar Cotton Mills Ltd.*, AIR 1962 Cal 380 : (1963) 33 Com Cases 36 **followed** in *Kamala Bai v. Vithal Prasad Co. P. Ltd.*, (1993) 77 Com Cases 231 (Ker). A claim to rectify the register cannot be asked for *ex debito justitia*. An application for rectification made after an inordinate delay will not be entertained. *In re, Cuddalore Construction Co. Ltd.*, (1967) 37 Com Cases 440 (Mad).

The remedy provided by this section cannot be used to put in the register the name of a person who cannot, in fact or in law, be called the owner of the shares. The court (now CLB) must see that it does not put in the register a person who does not even have a *prima facie* title to the shares in question. *Dhelakhat Tea Co. Ltd., In re,* (1958) 28 Com Cases 62 : AIR 1957 Cal 476. Where no written application or written request for allotment of shares was made and shares were allotted under an oral agreement, it was held that the allotment did not comply with the requirement of s. 41 for membership and, therefore, that was a sufficient cause for ordering rectification of the register of members. *Indglobal Investment & Finance Ltd. v. Rajasthan Breweries Ltd.*, (2001) 3 Comp LJ 271 : (2001) 107 Com Cases 525 (CLB—NRB—N. Del).

Persons who become entitled to shares by transfer or transmission can claim registration of transfer or transmission. When a person has a legal right, the company must recognise his membership and enter his name in the register on his becoming a member and his predecessor in title ceasing to be a member. *Vidyasagar Cotton Mills Ltd. v. Mussamat Nazimunessa Begum,* (1964) 34 Com Cases 704 (Cal); *State of Orissa v. Indian Chemical Products Ltd.*, AIR 1957 Ori 203.

Where the assets of a company were taken over by another company, the court said that it did not have the effect that the shares of the members of the company were also taken over so as to enable any member of that company to ask the transferee company under this section to rectify its register and include his name in it in respect of the shares held by him in the company which transferred its assets. *Lalithamba Bai v. Harrisons Malayalam Ltd.*, (1988) 63 Com Cases 662 (Ker). On appeal against this decision the company was directed to rectify its register of members for entering the names of the petitioners. This was because of peculiar history of the case under which the court presumed that the actual transfer under the will of the original holder must have taken place. *Lalithamba Bai v. Harrisons Malayalam Ltd.*, (1997) 13 SCL 175 (Ker—DB).

The administrator of a deceased shareholder transferred the shares to a company in satisfaction of the debt of the deceased to that company. A legal heir of the deceased wanted this transfer to be struck out from the company's register of members saying that he had a pre-emptive right in respect of those shares. The court did not agree with him that it was a sufficient cause for rectification of the register. (1989) 67 Com Cases 491 (Cal). *Kalyani Sundaram v. Shardlow India Ltd.*, (1990) 67 Com Cases 306 (Mad). The title of the applicant to have his name entered in or omitted from the register of members could be decided in section 155 proceedings even though they were of a summary nature [now s. 111]. But the title mentioned in section 155(3) meant only the title regarding any of the matters referred to in section 155(1). *Kumaran Potty v. Venad Pharmaceuticals & Chemicals Ltd.*, (1989) 65 Com Cases 246, 250 (Ker).

A person purchasing securities is bound by the terms and conditions of the issue and also representations made on the face of the security, but is not affected by any other undisclosed understanding or agreement between the company and the original allottee. In this case, the company allotted bonds and issued letters of allotment to the allottee. The allottee transferred through the letter of allotment to a *bona fide* purchaser for value. The company rejected the transferee's application for registration of the transfer saying that it

had lien over the bonds for being an unpaid seller. This defence was not allowed to the company. *Canara Bank v. National Power Grid Corpn. Ltd.*, (2003) 48 SCL 543 : (2004) 58 CLA 54 (CLB).

Sufficient cause [Sub-section (4)(a)].—The Company Law Board had opportunity in its decision in *Tracstar Investments Ltd. v. Gordon Woodroffe Ltd.*, (1996) 87 Com Cases 941 (CLB—Mad) to explain the import of the words "sufficient cause" as used in S. 111(4)(*a*)(*i*). It is within the jurisdiction of the Company Law Board to examine whether the transfer in question is invalid either because there are statutory violations or because it is fraudulent or *mala fide* and these and other allied factors would constitute a sufficient cause. This approach of the CLB was **approved** by the Division Bench of Madras High Court in *Shoe Specialities Ltd. v. Tracstar Investments Ltd.*, (1997) 88 Com Cases 471 (Mad—DB) where after an extensive survey of authorities as to the way in which the directors are supposed to exercise their powers the court said that statutory violations are as much a breach of duty as a fraud would be. The transfers in question violated (*now repealed*) s. 22-A of S.C.R. Act, 1956 because that provision is for protecting the company from illegal and fraudulant transfers. The duplicate share certificates having been issued by an illegal processes, the registration of the transfer on their basis would involve statutory violation. The Bench was of the opinion that complications of this nature should first be had unraveled by referring the matter to a Civil Court and then going ahead with registration after waiting for a decision of the Civil Court where matters are decided on the basis of not merely documents and affidavits but also cross-examinations of persons involved. The misled transferee in such cases can sue the directors who defrauded him for his compensation but not the company.

The refusal to register a name because the petitioner had no instrument of transfer with him has been held to be a refusal based on a "sufficient cause" The application for rectification of the register of members was accordingly struck out. The court said that it had no jurisdiction to resolve issues relating to underlying share ownership which must be determined before the question of whether a person should be registered as a member can be tried—*Re Hoicrest Ltd.* (1998) 2 BCLC 175 (Ch D). The Court of Appeal, however, held that the court can exercise even in this summary nature proceedings the power of rectification for determining ownership of the petitioner's shares. *Keene v. Martin*, (1999) 2 BCLC 346 (CA); *Hoicrest Ltd. Re*, (1999) 2 BCLC 346 (CA); *Keene v. Martin* (2000) 1 BCLC 194 : (2000) 1 WLR 414 (CA); *Hoicrest Ltd. Re*, (2000) 1 BCLC 194 : (2000) 1 WLR 414 (CA).

Universal application to all kinds of companies.—The provisions of the section apply to all kinds of companies, even to companies licensed under Section 25. *Sha Hindumull Dalichand v. Madras Kirana Merchants Association*, (1956) 26 Com Cases 229.

Presumption of *bona fide* exercise of power.—The rectification of the register of members under this section can be granted only if it can be established that the directors had acted oppressively, capriciously or corruptly or in some way *mala fide* and not in the interest of the company. Such a plea has to be specifically raised in the petition and proved by evidence. Normally, the court would presume that the directors have exercised their power *bona fide* in the interest of the company. *Harinagar Sugar Mills Ltd. v. S. S. Jhunjhunwala*, (1961) 31 Com Cases 387, 400 : AIR 1961 SC 1669.

A plea of *mala fides* has, in a petition for rectification, to be expressly raised and affirmatively proved by evidence. *Shrimati Bina Barua v. Dalowjan Tea Co. (P.) Ltd.*, (1981) 51 Com Cases 660 (Gau).

Company need not be at fault.—It is sufficient for an applicant to show that the register of members is incorrect because an entry had been omitted or made by error. It is not necessary to show any wrong by the company. The jurisdiction lies in maintaining the accuracy of the public register. *Fagin's Bookshop plc., Re*, 1992 BCLC 118 (Ch D).

Questions of complexity, title and summary jurisdiction.—In *Public Passenger Services Ltd. v. M. A. Khadar*, (1966) 36 Com Cases 1 : AIR 1966 SC 489, the Supreme Court held that where by reason of complexity or otherwise the matter might be more

conveniently decided in a suit, the court might refuse relief under this section and relegate the parties to a suit. In the instant case, however, the court held that the validity of a notice of forfeiture impugned in the proceedings could well be decided summarily and having found that the notice was defective and invalid the court could not arbitrarily refuse relief to the respondents. But now, since the amendment of 1988, the parties cannot be asked to go to a court of law on any grounds whatsoever.

Similarly where the petitioners' claim was on the bases of various documents which showed that there names were removed from the company's register of members after having been entered in the register and the company disputed the genuineness of those documents, it was held that these complications of law and fact could not be resolved on a summary adjudication and that the matter required a full trial on evidence in a civil suit. *Bipin K. Jain v. Savik Vijay Engg. P. Ltd.*, (1998) 91 Com Cases 835 : (1997) 26 Corpt LA 255 : (1997) 4 Comp LJ 255 (CLB—Mad).

The Full Bench of the High Court of Delhi, reasserted what has remained an established principle all along, that the provision in section 155 (now merged in section 111) is a complete jurisdiction and that the parties can be relegated to a civil suit only in an extreme case of factual complexity which cannot be sorted out in a summary procedure and that the company court in arriving at this decision must see for itself whether the disputes raised are real or only a pretence for having the matter to be carried to the doors of a civil court. *Ammonia Supplies Corporation P. Ltd. v. Modern Plastic Containers P. Ltd.*, (1994) 79 Com Cases 163 : AIR 1994 Delhi 51 (FB). **Following** this decision in *Ammonia Supplies Corporation P. Ltd. v. Modern Plastic Containers P. Ltd.*, (1994) 2 Comp LJ 322 (Del), the Court added that a regular suit would be necessary even where the petitioning company is in winding up and leave of the winding up court would be necessary. The Supreme Court in *Ammonia Supplies Corpn. P. Ltd. v. Modern Plastic Containers P. Ltd.*, (1998) 94 Com Cases 310 (SC) **reversed** the decision of Full Bench of the Delhi High Court to this extent that instead of directing the parties to civil suit, the court should, [in view of long delays already caused, case pending since 1984] have it adjudicated under S. 446 by the Company Judge of the High Court. See also *A Akhilandam v. Great Eastern Shipping Co. Ltd.*, (2000) 1 Comp LJ 110 : (2000) 36 CLA 23 (CLB–WB) (complications arising out of unauthorised sale of shares by a bank to whom the shares were not even pledged and, therefore, had no lien over them, fit for civil court adjudications. See also *Tarsen Kansil v. Dev Spinners Ltd.*, (2000) 37 CLA 132 : 2000 CLC 957 : (2000) 24 SCL 519 : (2001) 103 Com Cases 835 (CLB–NB) a case involved forgery, misrepresentation, manipulation, referred for civil court adjudication.

Where the question involved was whether the petitioner was a true transferee of the shares in question and questions of fraud, *etc.* did not arise, it was held that it was not necessary to drive the parties to a civil suit. The company court should not hesitate to exercise its jurisdiction where the matters are not too complicated and can be sorted out on the basis of evidence produced by the parties. Where the company is taken over by another company during the pendency of the proceedings, that other company need not be impleaded. *V.L. Pahade v. Vinay L. Deshpande*, (1999) 97 Com Cases 889 : (1999) 22 SCL 21 : (2000) CLC 97 (AP).

The Company Court had jurisdiction under S. 155 (now repealed and absorbed into S. 111 of the Act) to decide all questions involving rectification. Where the Company Court felt that the matter did not fall within the scope of rectification, e.g., disputes involving ownership, fraud, forgery, *etc.*, it could relegate the parties to a civil suit. *National Insurance Co. Ltd. v. Glaxo India Ltd.*, (1999) 98 Com Cases 378 : (1999) 2 Comp LJ 205 : (1999) 34 CLA 30 : (1999) 20 SCL 243 (Bom).

A petition was filed under section 111 seeking rectification of the registers of several companies of a group of which the petitioner's father had been chairman till his death and which were controlled and managed by his brother thereafter. The grounds were fraudulent transfers, forgery of share transfer documents and minutes books of the companies,

etc. The Company Law Board dismissed the petitions on the view that a convenient disposal was not possible under the summary proceedings under section 111. The parties should seek adjudication of their disputes in the appropriate civil court. *Mahesh Batra (Dr.) v. Gajaraj Beverages P. Ltd.*, (2002) 51 CLA 4 : (2002) 40 SCL 364 (CLB). The Editor of the report has made the following suggestion : "The Supreme Court held in *Dr. JJ. Merchant v. Shrinath Chaturvedi*, (2002) 6 CLA-BL Supp 1 that the National Consumer Disputes Redressal Commission, which is required to be headed by a retired Judge of the Supreme Court and that the State Consumer Disputes Redressal Commission which is required to be headed by a retired High Court Judge are competent to decide complicated issues of law or facts and hence it would not be proper to hold that in cases where negligence of experts is alleged, consumers should be directed to approach the civil court. This judgment may be applicable with equal force to the Company Law Board in circumstance such as those set out in its order".

To the extent to which sections 111 and 111A confer jurisdiction on the Company Law Board to order rectification of register of members, it need not ask the parties to go in for a civil suit even if questions of title are involved unless they are not capable of being resolved without a full trial on facts. *Volvo Lastvagnar Komponenter v. Morgard Shammar India Ltd.*, (2000) 100 Com Cases 131 : (1998) 4 Comp LJ 112 (CLB—NB).

The Company Law Board must record a finding as to how the matter in question is covered by any of the provisions of s. 111(4) as to rectification of register of members and, therefore, the power became exercisable. *TG Veera Prasad v. Shree Rayalaseema Alkalies and Allied Chemicals Ltd.*, (1999) 98 Com Cases 806 (AP).

However, there was a divergence of views amongst the High Courts. Some courts had held that the jurisdiction under section 155 was a summary jurisdiction and the court was not bound to decide complicated questions of title. The proper course in such cases was to go to the Civil Courts. *Joginder Singh v. Basawa Singh*, (1985) 58 Com Cases 843, 850 (P&H); *Surendra Kaur v. Singh Engineering Works (P.) Ltd.*, (1977) 47 Com Cases 638 (Punj); *Mahendra Kumar Jain v. Federal Chemical Works Ltd.*, (1965) 35 Com Cases 651, 653 (All); *Mylavarapu Ramakrishnana Rao v. Mothey Krishna Rao*, AIR 1947 Mad 322 : (1947) 17 Com Cases 63; *Re, Dhelakhat Tea Co. Ltd.*, AIR 1957 Cal 476 : (1958) 28 Com Cases 62; *Jayshree Santaram Vankudre v. Rajkamal Kalamandir (P.) Ltd.*, (1960) 30 Com Cases 141 : AIR 1960 Bom 136 (Questions of forgery and fabricated documents); *S. Bhagat Singh v. Piar Bus Services Ltd.*, (1960) 30 Com Cases 300 : AIR 1959 Punj 352; *Smt. Puran Devi v. S. Gurnam Singh*, (1977) 47 Com Cases 796 (P&H); *Ramesh Chander v. Wearwell Cycle Co. (India) Ltd.*, (1966) 36 Com Cases 252 (Del); *Manilal Gangaram Sindore v. E.I. Theaters Ltd.*, (1963) 33 Com Cases 826, 828 : AIR 1963 Bom 40; *Lakshmi Narayan Bhayya v. Praga Tools Corpn. Ltd.*, (1953) 23 Com Cases 198, 199 (Hyd); *Madras Bangalore Transport Co. P. Ltd. v. K.A. Sebastian*, 1975 Tax LR 2063 (Ker); *Basudeb Kataruka v. Dhanbad Automobiles Private Ltd.*, (1977) 47 Com Cases 68 (Pat); *Kamla Devi Mantri v. Grasim Industries Ltd.*, (1990) 69 Com Cases 188 (MP); *Kalyani Sundaram v. Shardlow India Ltd.*, (1990) 67 Com Cases 306 (Mad)(Question about title capable of being decided on affidavits); *Shrimati Somavati v. The Lord Krishna Sugar Mills Ltd.*, AIR 1966 Punj 44, allegations of fraud and fraudulent forfeiture of shares raised after twelve years. *S. Guru Charan Singh Mahant v. Rattan Sports P. Ltd.*, (1986) 59 Com Cases 279 (P&H), long delay and averments involving voluminous evidence; *Rakesh Kumar Malik v. Rohtak Ashok Theatres (P.) Ltd.*, 1985 Tax LR 2055 (P&H); involving question of disputed rights and the question as to the validity of appointment of directors; *Vishnu Dayal Jhunjhunwala v. Union of India*, (1989) 66 Com Cases 686 (All), appellate court refusing to interfere in the decision of a single judge that complicated questions were involved. *Kamla Devi Mantri v. Grasim Industries Ltd.*, (1990) 69 Com Cases 188 (MP). (Doubts about validity of will cannot be considered under this jurisdiction). *T.G. Veera Prasad v. Shree Rayalaseema Alkalies & Allied Chemicals Ltd.*, (1997) 89 Com Cases 13 (CLB—Mad); *G.N. Bayra Reddy v. Arathi Cine Enterprises P. Ltd.*, (1997) 89 Com Cases 745 (CLB—Mad).

On the other hand, the Calcutta High Court had held that although this section conferred a summary jurisdiction, the parties need not be relegated to a suit but the company court could itself try the complicated questions. See *Daddy S. Mazda v. Irani,* (1977) 47 Com Cases 39 (Cal). The Gujarat High Court had also held that the jurisdiction was not summary but was wide and extensive. *Gulabrai Kalidas Naik v. Lakshmidas Patel,* (1978) 48 Com Cases 438 (Guj) **followed** in *Swaminathan (E.V.) (Mrs.) v. KMMA Industries and Roadways P. Ltd.,* (1993) 76 Com Cases 1 (Mad), the Court however adding that the court could decide all complicated questions whether of Act or of law. The transfers which were ordered to be rectified in this case were effected without any documents and also without observing the proper procedure. It was observed that the power conferred by this sub-section would become seriously curtailed if it were to be held that the power is of summary nature. Accordingly, there was the power under the sub-section to examine questions of title as between the opposite parties. The same view was adopted by the High Court of Delhi in *Harnam Singh v. Bhagwan Singh,* (1992) 74 Com Cases 726, 732 (Del), the Court observing that jurisdiction under this section read with Rule 6 of the Companies Court Rules was co-extensive with that of a Civil Court. An order under this section is not so summary as is contemplated under the English Law. It contemplates decisions of questions relating to title and also 'provides for an appeal from the decision of such an issue. *State of Orissa v. Indian Chemical Products Ltd.,* AIR 1957 Ori 203, 212. See also *Mathew Michael v. Teekoy Rubbers India Ltd.,* (1983) 54 Com Cases 88 (Ker). **Affirmed** in (1988) 2 Comp LJ 70 (DB)(Ker). However in *Anil Gupta v. Delhi Cloth & General Mills Co. Ltd.,* (1983) 54 Com Cases 301 (Del), B. N. KIRPAL J., refused to follow the decision of the Gujarat High Court in *Shree Gulabrai Kalidas Naik, (Supra),* holding himself to be bound by an earlier Division Bench judgment of the Delhi High Court: *Punjab Distilling Industries v. Biermans Paper Coating Mills Ltd.,* (1973) 43 Com Cases 189 (DB—Del), where it was held that complicated questions of fact should be decided in a civil suit.

Every allotment of shares brings about changes in the company's register of members. Rectification of the register of members is within the jurisdiction of the Company Law Board. This may involve an enquiry into the validity of an allotment of shares. Thus, the Board has jurisdiction to enquire into the matters relating to allotment of shares. But the Board may refrain from exercising this jurisdiction where the factors connected with the vires of an allotment are full of such factual complexity as can be sorted out only in a full trial before a civil court. *Shiv Dayal Agarwal v. Sidhartha Polyester P. Ltd.,* (1996) 88 Com Cases 705 (CLB—NR); *Shukla Mahajan (Smt.) v. Sidhartha Polyester P. Ltd.,* (1996) 88 Com Cases 705 (CLB—NR).

Where the allegations were that the allotment of shares in a family company was made beyond the limit of the authorised capital and that shares were allotted to non-members and all this required proof because the records of the company did not show any such happening, the CLB said that a civil suit was the only proper method of sorting out such facts. *Nupur Mitra v. Basubani P. Ltd.,* (2001) 3 Comp LJ 244 : (2001) 41 CLA 306 : (2001) 31 SCL 1 : (2001) CLC 1102 (CLB—Cal).

Since the power was discretionary the court might admit petition even where complicated questions arose. Certain shares were allotted to a foreign collaborator in return for the machinery supplied by him to the company. A shareholder applied to the Companies Tribunal (since abolished) under section 155 [Now section 111(4)] for removing the name of the collaborator on the ground that the machinery supplied by him was out of date and defective and that it was not worth even a fraction of the value of shares allotted to him. It was held that this problem was likely to raise several points on which technical and expert evidence would be necessary, which could not be dealt with under section 155 [Now section 111(4)]. The Companies Tribunal had rightly rejected the application. But the other question that the shares were allotted to the collaborator in violation of Capital Issues Control Act, 1947, [since repealed] should have been heard and considered under this section. *Punjab Distilling Industries Ltd. v. Biermans Paper Coating Mills Ltd.,*

(1973) 43 Com Cases 189 (Del) (DB). In another case, a shareholder died. Five years after his death his widow and children applied for transmission of the shares in their names. The company refused to register saying that those shares had been entered in the name of a trust to which the shares had been bequeathed under the will of the shareholder. It was held that unless the will was set aside, the company could not be castigated for having transmitted the shares in favour of the trust. Whether the will was genuine or bogus would necessarily involve complicated factual matters. The summary remedy of section 155 [Now s. 111(4)] was not suitable. *Surendra Kaur v. Singh Engg. Works Pvt. Ltd.*, (1977) 47 Com Cases 638 (All).

Where the documents of transfer of shares lodged with the company were proper and complied with the requirements of S. 108 and one of the questions was whether the agreement of transfer itself was rendered infructous because of breach of its terms, the Company Law Board said that it could not go into that question. The rectification of the register of members was refused. The contentious issues raised by the parties regarding fraudulent manipulation of duplicate share certificates, fabrication of transfer instruments and other records could not be resolved in a summary proceeding by the Company Law Board. *S. Anuratha v. A.K.M.N. Cylinders P. Ltd.*, (1999) 95 Com Cases 555 : (1999) 1 Comp LJ 363 : (1999) 32 CLA 47 (CLB—SB).

Questions of title.—In its decision in *Harnam Singh v. Bhagwan Singh*, (1992) 74 Com Cases 726 (Delhi) the High Court of Delhi proceeding under the erstwhile s. 155 of the Act, now merged in section 111(4), has taken the position consistent with the preponderance of authorities on the subject and now specially provided in section 111(7) that the court has the power to decide the questions of ownership and title about the shares in question. The court said that there is no authority for the position that despite the statutory provisions and Rule 6 of Companies (Court) Rules, 1959, questions of title to shares have to be decided by a civil court.

Where the question of the ownership of certain shares had already been decided under a decision of the apex court, the Delhi High Court held that the matter could not be reopened in a court of law. *Kulveer Chandhoke v. Eastern Linkers P. Ltd.*, (1995) 4 Comp LJ 587 : (2001) 103 Com Cases 997 (Del); *Shankuntala Bali (Smt.) v. Eastern Linkers P. Ltd.*, (1995) 4 Comp LJ 591 (Del). In another case of the same kind, *K.P. Antony v. Thandiyode Plantations P. Ltd.*, (1996) 86 Com Cases 684 (Ker—FB), the ownership of and title to the shares under transfer after having been the subject-matter of a civil litigation had reached the stage of final declaration. Three parties had agreed to acquire shares of a company and to hold them jointly. Disputes arose because one of them was excluded from joint membership. He moved the company court and faced dismissal. The Division Bench allowed appeal against the order and declared that the plaintiff was entitled to his one-third part of the shares and directed the company to include his name in the register of members. The Supreme Court did not permit any appeal against the judgment of the Division Bench. It was held that the company court had the jurisdiction to decide questions of title to shares and that the order of the company court could be challenged only by proceeding in appeal against it and not in the execution proceedings.

A person seeking registration of his name as a member by rectification of the register of members has to establish his title to the shares in question. The contract in question for transfer of shares was found by Civil Court to be not complete. *K.S. Narayana Iyer v. Talayar Tea Co.*, (1995) 83 Com Cases 743 (CLB—SR).

There was order of settlement with regard to shares of one son only. This was followed by an application for distribution of the property by metes and bounds. The court said that it could not revive a petition which had already been disposed of. *D.K. Oswal v. Akshay Finance*, (2003) 115 Com Cases 577 : (2004) 50 SCL 303 : (2002) 6 Comp LJ 237 (Delhi) [The power under the then s. 155 used to be exercised by the court].

Arbitrators award as to title.—Where the question as to title of various parties involved was referred by the court with the consent of the parties to arbitration, the arbi-

trator's award as to the parties respective shares, was held to be final and binding on them. *Gurcharan Singh v. Raghbir Cycles P. Ltd.*, (1995) 82 Com Cases 203 (P&H).

Existence of register necessary for relief.—The court did not grant relief under the section where neither the register of members has been found nor is there any trace of the return as to allotment. *Rajnikant Ratilal Shah v. Deccan Farms & Distilleries Ltd. (In liquidation)*, (1978) 48 Com Cases 322 (Bom).

***Mala fide* refusal by directors.**—While the court will generally assume that the directors acted *bona fide* in the general interest of the company if it is seen that they acted in excess of power or in purported exercise of power under the articles they acted "oppressively, capriciously or corruptly or in some way *mala fide*" the court would intervene. If, on the other hand, the reasons disclosed are legitimate the court would not set aside the decisions of the directors merely because the court itself would have come to a different conclusion. The question is whether the directors acted in accordance with the articles and whether the power was exercised *bona fide* in the interest of the company (*Ibid*). See also *M.M. Anandaram v. Mysore Lachia Setty and Sons (P.) Ltd.*, (1985) 58 Com Cases 162 (Kar). If the directors refuse registration of share transfer for cogent reasons the same cannot be **overruled** under the section. *Bajaj Auto Holdings Ltd. v. Bajaj Tempo Ltd.*, (1987) 1 Comp LJ 116 (CLB).

Under S.155 the directors were not compellable to disclose their reasons for a particular refusal. But now under S. 111 the directors cannot refuse a transfer without a statement of reasons. See *Mathew Michael v. Tekoy (India) Ltd.*, (1990) 69 Com Cases 145, 156 (DB) (Ker), **affirming** *sub-nom* (1983) 54 Com Cases 88 (Ker); *P.V. Chandran v. Malabar & Pioneer Hosiery P. Ltd.*, (1990) 69 Com Cases 164, 171 (Ker) (DB).

Compliance with formalities necessary.—Because of a statutory restriction on shareholders, a person transferred some of his shares to a lady whose signature he obtained on a blank transfer form. He retained the share certificate and the transfer instrument. He secured the entry in her name in the register of the company. Subsequently, and still without the knowledge of the lady, he transferred the shares to another person who had apparently given no consideration. His name was entered in the register and that of the lady struck out. It was held that the lady was entitled to have her name put back in the register. *Lalitha (M.S.) v. Premier Insurance Co. Ltd.*, (1964) 2 Comp LJ 115 (Mad).

The court has power under the section to entertain a petition even where the petitioner has not complied with the requirements of S. 108 because, when once the petitioner has made out his title to the shares in question, the court can order the execution of the necessary documents for complying S. 108. The question of compliance with S. 108 arises only when the title to the shares is established. *K.P. Anthony v. Thandiyode Plantations P. Ltd.*, (1987) 62 Com Cases 553 (Ker). On appeal *K.P. Antony v. Thandiyode Plantations (P.) Ltd.*, (1996) 86 Com Cases 684 (Ker— FB). The mere fact of non filing of the share transfer forms cannot be ground for dismissing the petition on merits. *Antony v. Thandigode Plantations Ltd.*, 1986 KLT 49 (Ker—DB). But where the petitioner cannot even make out his title the court cannot help him. Mere acquisition of the assets of a company is not the same thing as the transfer of its shares unless there is also an agreement to that effect. *Lalithamba Bai v. Harrisons Malayalam Ltd.*, (1988) 63 Com Cases 662 (Ker). On appeal against this decision the company was directed to rectify its register of members for entering the names of the petitioners. This was because of peculiar history of the case under which the court presumed that the actual transfer under the will of the original holder must have taken place. *Lalithamba Bai v. Harrisons Malayalam Ltd.*, (1997) 13 SCL 175 (Ker—DB).

Compliance with Act and articles necessary.—It is necessary before invoking the jurisdiction of the court under S. 155 that the provisions of the articles of association have been complied with. Where the articles required that the share certificates in respect of the shares under transfer and transfer fee must be deposited with the company, it was held that without compliance with these requirements the court had no power to order rectifi-

cation. Depositing these documents in the court would not be sufficient. *In Re, Malabar & Pioneer Hosiery Pvt. Ltd.*, (1985) 57 Com Cases 570 (Ker). **Affirmed** in *P.V. Chandran v. Malabar and Pioneer Hosiery P. Ltd.*, (1990) 69 Com Cases 164 (Ker). The decision in *P.V. Chandran v. Malabar and Pioneer Hosiery P. Ltd.*, (*Supra*) was **relied** on in *Mathrubhumi Printing and Publishing Co. Ltd. v. Vardhman Publishers Ltd.*, (1992) 73 Com Cases 80 (Ker—DB) so as to hold, [**reversing** the decision of the single judge in *Vardhman Publishers Ltd. v. Mathrubhumi Printing and Publishing Co. Ltd.*, (1991) 71 Com Cases 1 (Ker)], that non-compliance with the articles in the matter of payment of transfer fee was fatal to the registration of the transfer and could not be cured by offering to pay the fee by depositing demand draft in the court. Similary where the instrument of transfer was executed by a person who had still not become a registered shareholder or had no other authority to deal with the shares, it was held that the transfer form was invalid and no order could be issued on the basis of such a form under section 155. *Pradip Kumar Sarkar v. Luxmi Tea Co. Ltd.*, (1990) 67 Com Cases 491 (Cal).

Rectification may not be allowed if some formality still remains to be complied with or if the directors have still not exercised their discretion as may be required by the articles. *Mariono's* case, (1867) 2 Ch App 596; *Hackney Pavilion Ltd., Re,* (1924) 1 Ch 276.

Where shares were purchased *bona fide* by an outsider and there was compliance of requirement of articles, the purchaser's right to have his name entered in the share register could not be denied. *Babulal M. Varma v. New Standard Coal Company,* (1967) 1 Comp LJ 161 (Cal).

Where, in the case of a private company, the articles required all transfers of shares to be approved by directors by a resolution, it was held that a transfer which was registered without this formality was liable to be struck out. No papers had been lodged with the company signifying the transfer. *Anand Hemant Patel v. Ornate Club P. Ltd.*, (2000) 99 Com Cases 318 : (2000) 1 Comp LJ 127 (CLB–WB).

Where the name of an unincorporated company was mentioned as a transferee in the transfer form, it was held by the CLB that a company being not competent to act before incorporation, the transfer form was not valid and the company was not compellable to rectify its register of members and to include in it the name of a company not yet duly formed. *Inlec Investments P. Ltd. v. Dynamatic Hydraulics Ltd.*, (1989) 3 Comp LJ 221 (CLB).

Where the articles specify no ground for refusal even then the directors would have a residuary power of refusal in the interest of the company. It would have to be exercised in good faith in the interest of the company with a statement of reasons. If this is not done an order for rectification can be made. It was also pointed out in this case that the adequacy of the stamps on the transfer form cannot be questioned by the company unless the company offers some proof of the facts that the price actually paid was higher than that mentioned in the deal. *Luxmi Tea Co. Ltd. v. Pradip Kumar Sarkar,* (1990) 67 Com Cases 518 (SC).

Where a transfer of shares was registered and the name of the transferee entered in the register of members without the transfer form being endorsed by the prescribed authority but this formality was subsequently complied with by Registrar's endorsement, rectification of the register of member was considered to be not necessary. *Shileswar Mishra v. Technotive Eastern P. Ltd.*, (1984) 1 Gauh LR 414 (Gau). The Court said that the Registrar's endorsement amounted to a condonation of the irregularity (*ibid*).

Locus standi.—Every shareholder has an individual right and interest in seeing that the share register reflects the true position. Therefore, he need not show any other injury or prejudice caused to him while seeking rectification. *Om Prakash Berlia v. Unit Trust of India,* (1983) 54 Com Cases 469, 501 (Bom) **reversed** in appeal on another point in *Unit Trust of India v. Om Prakash Berlia,* (1983) 54 Com Cases 723 (Bom) (DB). 'Any member of the company' can file a petition for rectification. *Arjan Singh v. Panipat Woollen and General Mills Co. Ltd.*, (1963) 33 Com Cases 534, 538 (Punj). Personal grievance is not necessary to give the applicant his *locus standi. Tracstar Investments Ltd. v. Gordon*

Woodroffe Ltd., (1996) 87 Com Cases 941 (CLB—Mad). **Affirmed** in *Shoe Specialities Ltd. v. Tracstar Investments Ltd.*, (1997) 88 Com Cases 471 (Mad—DB).

***Locus standi* on behalf of mutual fund.**—Banks have often to hold shares on trust account. It has been held that they have the right to apply for rectification of the register of members of the company, which was in this case, another public sector undertaking, in their representative capacity for having the bank's name substituted for the name of the mutual fund scheme which the bank is going to close. *Canara Bank v. Power Grid Corporation of India Ltd.*, (1996) 3 Comp LJ 360 : (1996) CLA 291 (CLB). This change-over of name became necessary because of the handicap created by the decisions of the Company Law Board in not permitting rectification where trust holdings were involved, in decisions like *Stock Holding Corporation of India v. National Thermal Power Corporation Ltd.*, (1996) 3 Comp LJ 112 (Bom) and *Bharat Petroleum Corporation Ltd. v. Stock Holding Corporation of India Ltd.*, (1995) 82 Com Cases 539 (CLB). Other decisions to the same effect were *Canara Bank v. National Thermal Power Corpn. Ltd.*, (1996) 4 Comp LJ 214 (CLB); *Stockholding Corporation of India Ltd. v. Bharat Petroleum Corpn. Ltd.*, (1997) 3 Comp LJ 112 : (1998) 91 Com Cases 862 (Bom) **affirming** *Bharat Petroleum Corpn. Ltd. v. Stockholding Corpn. of India Ltd.*, (1995) 82 Com Cases 539 (CLB—Bom). These decisions should now be taken in the light of the amendment to s. 153-B which provides that the provisions of s. 153-B would not apply where a trust is created to set up a Mutual Fund, or Venture Capital Fund or such other fund as may be approved by SEBI. Note should also be taken of the consequential amendments to s. 111 and the addition of a new section, namely, s. 152-A by the Depositories Act, 1996 and the abrogation of s. 153-B by Companies (Amendment) Act, 2000. There was an appeal against the decision of the CLB in *Canara Bank v. NTPC (Supra)* in which the High Court of Delhi **reversed** the CLB order. But on further appeal, the Supreme Court **set aside** the High Court's decision and **affirmed** the order of CLB. *Canara Bank v. National Thermal Power Corpn.*, 2000 (Suppl. 3) S.C. 491 : (2001) 1 Comp LJ 224 : (2001) 104 Com Cases 97 : (2001) 32 SCL 483 (SC). Payment was made after the Supreme Court order. The Company Law Board held that the bond-holders were entitled to interest for the period between the date of Company Law Board's order and the date of actual payment. *Canara Bank v. National Thermal Power Corpn. Ltd.*, (2002) 110 Com Cases 107 (CLB).

The intention of the Legislature in enacting this section appears to be to ensure maintenance of a register of members which reflects reality at any particular point of time. That is why the right to apply under this section is available to any member, without compelling him to show a particular or special prejudice caused to him by an incorrect register of members. *Killick Nixon Pvt. Ltd v. Dhanraj Mills Pvt. Ltd.*, (1983) 54 Com Cases 432 (Bom—DB).

Intervention of winding up.—Where the management and the control of a company are taken over by the Central Government in accordance with the provisions of Chapter III-A of the Industries (Development and Regulation) Act, 1951 and proceedings in winding up are stayed, the Court has no jurisdiction to direct rectification of the register of members under this section, even in execution of a decree, as long as the winding up proceedings are stayed. *Indian Bank v. Bengal Potteries Ltd.*, (1982) 52 Com Cases 471 (Cal).

Conversion of loan into shares.—Where an employee of the company had given a sum of money to the vice-chairman of the company by way of loan under the assurance that the amount would be converted into shares or paid back to him, but he was not able to show any resolution for allotting shares to him or any undertaking by the company to that end, it was held that the jurisdiction of section 155 [now section 111(4)] was not available to him for getting a direction that his loan be converted into shares. *Kumaran Potty v. Venad Pharmaceuticals & Chemicals Ltd.*, (1989) 65 Com Cases 246, 250, 251 (Ker).

Section applies to section 25 companies.—The provisions of this section apply to all kinds of companies, even to companies licensed under section 25. *Sha Hindumull Dalichand v. Madras Kirana Merchants Association*, (1956) 26 Com Cases 229 (Mad).

Instrument of transfer with uncancelled stamps.—Where the directors refused to accept an instrument of transfer which was duly stamped, but the stamps were not cancelled, it was held that the relief of rectification of the register could not be sought on the basis of such a form. It is not a mere formal defect. The Court cannot give a direction to the company to register the transfer by rectifying the register when the instrument is carrying a patent defect on its face generated by the fact that the stamps were not cancelled as required by section 12 of the Indian Stamp Act, 1899. *Nuddea Tea Co. Ltd. v. Ashok Kumar Saha,* (1988) 64 Com Cases 775 (Cal). The same position was taken by Division Bench of Kerala High Court in *Mathrubhumi Printing and Publishing Co. Ltd. v. Vardhaman Publishers Ltd.,* (1992) 73 Com Cases 80 (DB)(Ker). Where the stamps were not cancelled at the time of the execution and were cancelled only before the instrument was presented to the company and the Court held that the instrument was not 'duly stamped' and therefore the company could not be compelled to act on such an instrument. Both the above cited cases were **followed** in *Muniyamma v. Arathi Cine Enterprises P. Ltd.,* (1993) 77 Com Cases 97 (Kar—DB). Where the stamps on the transfer documents were not cancelled at the time of the execution and were defaced by the company before registering the transfer, it who held that the transfer was not valid and was open to rectification and that all the persons to whom the shares were transferred after the impugned transfer would have to be impleaded as parties for restoration of status *quo ante. Subhash Chandra v. Vardhman Spinning General Mills Ltd.,* (1995) 83 Com Cases 641 (CLB—Delhi).

Power to repudiate registered transfer.—"Even if a company enters the name of a transferee of shares on *prima facie* evidence of a sale, the entry of the name of transferee in the share register can be challenged in an application under section 111 on the ground of illegality and fraud committed by its officers and other persons". *Turner Morrison & Co. Ltd. v. Shalimar Tar Products* (1935) Ltd., (1980) 50 Com Cases 296 at 313 (Cal). Where the officers authorising the registration of a transfer themselves have been the victim of a fraud played by the transferee and the officers, but for such fraud, would not have registered the transfer, the company may on discovering the truth repudiate the registration. *De Pass's* case, (1859) 4 De G & J 544; *Lindlar's* case, (1910) 1 Ch 312. Where the directors have a discretion as to registering transfers and the consideration is misstated, the company, on discovering the facts, may repudiate the transfer and restore the transferor's name to the register. *Snow's* case, (1871) 19 WR 1057; *sub nom, Rogers'* case, 25 LT 406; *Cf. Weston's* case, (1868) LR 4 Ch 20. "The regulations of the company may impose fetters upon the right of transfer. But in the absence of restrictions in the articles the shareholder has by virtue of the statute the right to transfer his shares without the consent of anybody to any transferee, even though he be a man of straw, provided it is a *bona fide* transaction in the sense that it is an out and out disposal of the property without retaining any interest in the shares". *Delavenne v. Broadhurst,* (1931) 1 Ch 234, 238. There is no time-limit for questioning the validity of a registered transfer where it has been effected contrary to the articles. *Tett v. Phoenix Property and Investment Co. Ltd.,* (1986) BCLC 149 (CA) or where it has been registered without the authority of the member. *Farhat Sheikh v. Escman Metalo Chemical P. Ltd.,* (1991) 71 Com Cases 88 (Cal), here by misusing a general power of attorney given by the member a part of her shares were transferred by the attorney in the name of his sons and that was held to be improper. One of several transferors revoking his signature on mere suspicion of a breach of trust does not justify an absolute refusal to register. In such circumstances it was the duty of the company to require the transferor who purported to revoke his signature within a reasonable time to take proceedings to prevent the registration: and if he failed to do so, the company can register the transfer. *Grundy v. Briggs,* (1910) 1 Ch 444.

Where the transferor was disputing his signature and the stamps on the transfer forms were also not cancelled, the transfer was nevertheless registered, it was held that the relief of rectification to the transferor would not be provided without the transferee, whose po-

sition was affected, being impleaded. *Subhash Chandra v. Vardhman Spinning and General Mills Ltd.*, (1995) 83 Com Cases 641 (CLB).

Rectification of register of members by removing registered transfer [Sub-section (4)(a)(i)].—The petition was by a father seeking removal from the register of members his minor son's name as shareholder. He disputed the validity of the transfer forms under which the minor's name was entered in the register and which were executed by the minor's mother on his behalf. The records of the company showed that the mother had been acting as a natural guardian throughout. The father was present at the meeting in his capacity as an officer of the company which approved the transfer but did not object. His objections came one year after that date. He had naturally lost the *locus standi* to question the validity of the entries. He was also not able to show anything wrong in the form and formalities under which the entries were made. *Jonas Hemant Bhutta v. Surgi Plast Ltd.*, (1993) 78 Com Cases 296 (CLB).

Necessary and proper parties.—Third parties whose rights may be affected by an order of rectification are necessary parties to the proceeding and the court cannot order rectification in their absence. *Jawahar Mills Ltd. v. Shah Mulchand & Co. Ltd.*, (1949) 19 Com Cases 138 (Mad). **Reversed** on another point in *Sha Mulchand & Co. v. Jawahar Mills Ltd.*, (1953) 23 Com Cases 1 : AIR 1953 SC 98. The directors are not necessary or proper parties to an application for rectification of the register. *Ratanlal v. Jagadhari Light Railway Co. Ltd.*, (1946) 16 Com Cases 21 (Lah). It is not necessary that all shareholders should be made parties to the case. *Basudeb Kataruka v. Dhanbad Automobiles P. Ltd.*, (1977) 47 Com Cases 68 (Pat); See also *Amrit Kaur Puri v. Kapurthala Flour Oil and General Mills Co. P. Ltd.*, (1984) 56 Com Cases 194 (P&H).

Rectification was not ordered when the alleged transferor was not before the court and there was a real doubt as to the *bona fides* or validity of the transaction. *Luchmee Chund v. Bengal Coal Co.*, (1882) ILR 8 Cal 317.

Effect of delay in seeking rectification.—An application for rectification after winding up will be refused, if made after long unexplained delay, even though the case may be a proper one for rectification. *T.V. Somasundaram Pillai v. Official Liquidator*, (1967) 37 Com Cases 440 (Mad).

A liquidator, however, may apply, and there will be no question of delay in his case; as the cause of action for his application will arise only on the making of the order for winding up. *S. K. Shankra, Official Liquidator v. Sardar Haridhan Singh*, (1966) 36 Com Cases 209 (Punj—DB).

A person who claims to have been misled by fraud by taking shares of a company must raise objection without delay. A delay of more than 3 years was held to be fatal to the petitioner. *Harjit Singh Giani (Dr.) v. Shri Ram Kumar*, (1964) 34 Com Cases 402 (Punj); *Mathew (C.) v. Cochin Stock Exchange Ltd.*, (1997) 4 Comp LJ 455 : 26 Corpt LA 312 (CLB—Mad) (delay of 11 years). Where the Court (now CLB) was satisfied that a party to the proceeding under this section was entitled to equitable relief, mere laches or delay on his part did not disentitle him to such relief. *Promila Bansal v. Wearwell Cycle Co. (India) Ltd.*, (1978) 48 Com Cases 202 (Del). An application for rectification of the list of contributories should be made without delay. Once a winding up order is made and a person's name included in the list of contributories, an application for rectification does not lie. *National Planners Ltd. (in liquidation) v. Ramkumar*, (1964) 34 Com Cases 402 (Punj).

Where no consideration was fixed for the transfer of shares and therefore it could not be examined whether the stamp duty paid was adequate to the value of the shares it was held that the transfer was illegal and therefore its validity could be questioned even after a length of time. Acquiescence, estoppel and laches was no bar to such questioning. *Mani (M.S.) v. M.S. Madhusoodnan*, (1991) 5 Corpt LA 187 (Ker—FB).

Delay is no bar if the contract is void *ab initio* and rectification can be done even when winding up is in progress. *Gorrissen's* case. *In Re, Monarch Insurance Co.,* (1873) 8 Ch App 507; *Wynne's* case, (1873) 8 Ch App 1002; *Beck's* case, (1874) 9 Ch App 392; *Baillie's* case (1898) 1 Ch 110; *Alabaster's* case, (1868) 7 Eq 273; *Oakes v. Turquand, Re, Overend Gurney & Co.,* (1867) LR 2 HL 325.

Transfer of shares where ceiling provided in the articles.—Where the articles provide a ceiling as to the number of shares to be permitted to a member, a member who transfers the shares to another member with knowledge that other is already holding his maximum, the company may refuse registration. If the transferor is a director he will be deemed to have notice of the fact and will remain a contributory in respect of his shares. *Newcastle-upon-Tyne Marine Insurance Co., Ex p., Brown* (1854) 19 Beav 97.

Where the articles provided a ceiling over the number of shares per shareholder and further provided that shares held by a member in excess would not give him voting rights, it was held that the company would not be able to prevent a shareholder from holding shares beyond the ceiling if he were prepared to do so without using the voting rights on the excess lot. *M. Ratnavarma Padival v. Karnataka Theatres Ltd.* (2000) CLC 489 : (2000) 38 CLA 171 (Kant).

Allotment beyond authorised capital.—Allegation that an allotment of shares in a family company was made beyond the limit of the authorised capital which was in violation of the Act and the allotment was in favour of non-members which was in violation of the articles, would have justified an order of rectification, but no evidence was offered in proof of the allegations. On the contrary, the records of the company did not show any such happening. If any such allotment is ordered to be cancelled, an order for corresponding reduction of capital can also be passed. *Nupur Mitra v. Basubani P. Ltd.,* (2001) 3 Comp LJ 244 : (2001) 41 CLA 306 : (2001) 31 SCL 1 : (2001) CLC 1102 (CLB—Cal).

Allotment in violation of articles.—An allotment in violation of the articles can be rectified under this section. A clause in the articles of a private company provided that the unissued shares would be allotted to the members in proportion to their present shares. The petitioner who was both a shareholder and a director alleged that the new shares were allotted by two directors to their own relatives without calling a meeting of the Board and for the purpose of increasing their majority. He prayed for cancellation of the allotment and removal of the names of the allottees from the register. Rejecting the company's contention that complicated questions of fact were likely to arise, the court held that the simple question was whether there was any violation of the articles. This was not such a complex question that it could not be decided in a summary proceeding. The court noted that the directors had not exercised their power in good faith in the interest of the company. The allotment was quashed and the register ordered to be rectified. The court did not consider it necessary that all the shareholders should have been made parties to the case. *Basudeb Kataruka v. Dhanbad Automobiles Pvt. Ltd.,* (1977) 47 Com Cases 68 (Pat); See also *Amrit Kaur Puri v Kapurthala Flour, Oil & General Mills Co. Pvt. Ltd.,* (1984) 56 Com Cases 194 (P&H).

Where rectification by cancelling an allotment would have the effect of reducing the company's capital, the CLB would not provide the relief because it has no power to order the reduction of capital. *Bhupinder Rai v. S.M. Kannappa Automobiles P. Ltd.,* (1996) 86 Com Cases 18 (CLB—SR).

Allotment in violation of conditions of issue.—A bond-issuing corporation was not permitted to say in reference to a *bona fide* buyer of bonds in the open market that the allotment was in violation of some of the conditions subject to which the Controller of Capital Issues had permitted the issue, namely, that 20% of the bonds must be issued to the public over the counter. Any such violation by the company or its allottee was held to be irrelevant because the letters of allotment did not carry any such condition. Rather they expressly stipulated that they were freely transferable. The corporation had not made any reference to the CLB under (now repealed) s. 22A of SCRA. The issue of bonds was

by HUDCO. The original allottee transferred the allotment through the allotment letters to the Standard Chartered Bank. The Company Law Board ordered that the refusal to register the transfer was not justified. *Standard Chartered Bank v. Housing and Urban Development Corporation Ltd.*, (1996) 4 Comp LJ 225 (CLB). An appeal against the decision was **dismissed** in *Housing and Urban Development Corporation Ltd. v. Standard Chartered Bank*, (1996) 23 Corpt LA 198 at 206 (Del) where the court added that if the Standard Chartered is denied registration in circumstances that arose in this case it would create havoc with the functioning of the securities market with serious repercussions on a growing economy. It would amount to strangulating he respiratory system of a market economy.

Relaxation of lock-in-period.—Where the shares under transfer were bound by a lock-in-period as mandated by Controller of Capital Issues but SEBI had relaxed the condition of the lock-in-period, it was held that the SEBI being the only regulatory authority of the securities market, it had power to vary the conditions imposed by the CCI. Action of SEBI was held to be proper and all the petitions challenging the rectifications were dismissed. *S. Chandrasekar v. Veena Textiles Ltd.*, (2000) 3 Comp LJ 148 (CLB–SB).

Allotment in violation of shareholders' agreement.—The facts of the case and the principles of law laid down appear from the following passage in the order of CLB in *Jitendra Nath Saha (NRI) v. Shyamal Mondal*, (1995) 82 Com Cases 638 (CLB): It is quite clear that in an application under section 111(4) of the Act, Company Law Board is competent to consider all relevant facts and circumstances, and see whether the principles of justice and equity and fair play were observed; and if not, it may declare the transaction invalid. In the case before us, the Board of directors of the company which comprises of husband and wife who are also shareholders of the company raised capital of the company from time to time without offering them to the remaining existing shareholders of the company, and in that process, they raised their own holdings from 25 per cent to 91 per cent. When the Board of directors felt the need of raising the capital, they should have offered the further shares to the existing shareholders based on the arrangement among promoters which was part of the records of the company; and if any such shareholder was not willing to participate in further capital, they could have allotted the shares to others in exercise of the discretionary power under the articles of association. But what has really happened is that the directors kept the remaining shareholders in the dark, and proceeded to allot shares to themselves, and three outsiders even though the remaining shareholders were eager to participate in the further capital of the company. The manner in which the directors have allotted shares to themselves and others, is a clear breach of their fiduciary duties, is not *bona fide*, lacks probity and they should not be allowed to derive any benefit from such transactions."

Allotment in statutory violations.—The petition was filed by an allottee of shares at a premium alleging that there was lack of agreement for purchasing shares at a premium. The valuation of premium was done without following the official guidelines. It was also not in consonance with the provisions of the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations 2000. This was held to be sufficient to order rectification of the register. *Kumar Malavalli v. CRCW Search Technologies P. Ltd.*, 2003 CLC 1198 (CLB) : (2003) 56 CLA 1198 : (2003) 48 SCL 582.

Allotment in violation of s. 108-A.—Where allotment is made in violation of section 108-A or of section 372A, it would constitute sufficient cause for the company to rectify the register with the permission of CLB by deleting the name of the allottee from the register as the holder of the shares.

Directors exceeding their authority.—Where articles empowered the directors to refuse a transfer on the ground that the transferee was not a proper person to have as a member of the company, it was held that this power could not be used to refuse to regis-

ter a transfer on the ground that the transferee was trying to corner the company's shares. *South Indian Bank Ltd. v. Joseph Michael,* (1978) 48 Com Cases 368 (Ker—DB).

Where the articles authorised the directors to refuse a transfer of shares which were not fully paid up or over which the company had a lien, it was held that this power could not be used to reject a transferee on personal grounds, if the shares were fully paid-up and also free from the company's lien. *Sanatan Investment Co. Pvt. Ltd. v. Premchand Jute Mills Ltd.,* (1983) 54 Com Cases 186 (Cal).

Directors can no longer refuse to give reasons for their decision to refuse a transfer. The amendment of 1988 has ruled out all the earlier cases which gave latitude to the directors in this respect. The position now is that an adverse presumption would be drawn in all cases of blank refusals. Earlier to 1988 a presumption of this kind was not drawn. *Coimbatore Kamala Mills Ltd. v. T. Sundaram,* (1950) 20 Com Cases 61, 64 (Mad).

The authority of the directors to refuse to register a transfer must emanate from some source. It should be grounded upon some provision in the Companies Act or in the articles of the particular company. Where in a particular case no such power is shown to exist and though, in such a case, there may still be a residuary general power in the hands of directors to refuse to accept a transfer in the interests of the company, it would still not be an absolute power. It would have to be exercised in good-faith in the interest of the company with a statement of reasons. Where this is not done, the court can intervene and order rectification of the register. The court also added that the adequacy of the stamps affixed on the transfer form cannot be questioned by the company unless the company offers some proof of the fact that the price actually paid was higher than that mentioned in the deed. *Luxmi Tea Co. Ltd. v. Pradip Kumar Sarkar,* (1990) 67 Com Cases 518 (SC) (on appeal *Pradip Kumar Sarkar v. Luxmi Tea Co. Ltd.,* (1990) 67 Com Cases 491).

Though the court has no power under section 155 to demand from the directors the reasons for their refusal and cannot direct rectification in the absence of positive evidence to show that their refusal was arbitrary, capricious or corrupt, the court can see whether the directors have arrived at their decision and communicated it to the transferee within the statutory framework. Thus where Rule 19(3)(*e*) of the Securities Contracts (Regulation) Rules, 1957 was applicable and the directors had not communicated their decision to the transferee within one month as prescribed by that rule, they were directed to rectify the register and include in the register the name of the transferee. *Joseph Michael v. Travancore Rubber and Tea Co. Ltd.,* (1989) 66 Com Cases 491 (Ker).

No relief was provided under the section to an employee of the company who claimed that he had advanced to the company a sum of money by way of a loan under the assurance of the vice-chairman that his loan would be converted into shares. There was no proof of the fact whether the vice-chairman had any such authority in the matter and whether there was any application for allotment of shares which had ever been presented before the Board of directors. The court said that the matter of the loan should have been first dealt with at the level of a civil suit. *Kumaran Potty v. Venad Pharmaceuticals and Chemicals Ltd.,* (1989) 65 Com Cases 246 (Ker).

Where the directors refused a transfer saying that the transferee was the *benamidar* of a person who was an undesirable person because as shareholder he had adopted an obstructive attitude, but no evidence was produced to show that the transferee himself was an undesirable person and that the transfer in his favour would prejudice the interests of the company, the directors' decision was quashed and they were directed to rectify the register and include therein the name of the transferee. *V.S. Ratnam v. Ossor Estates Ltd.,* (1989) 2 Comp LJ 355 (CLB).

Directors restricting their authority.—A resolution of the board of directors declaring that all transfer of shares lodged upto the next annual general meeting would be approved by it without claiming any lien on them was held to be *ultra vires* and was not binding on the company. Accordingly, when the company refused to receive the transfers tendered to it, it was held that the transferors were not entitled to have the transfers reg-

istered without the directors being permitted to consider each separate transfer. Rectification of register was not allowed. *Ramdas v. New Great Eastern Spinning and Weaving Co.*, (1899) 1 Bom LR 269.

Director's power to rectify entries.—Where, after the name of any person was entered in the register, it is found that the allotment to him was illegal and void or that the entry was for any other reason invalid and there is no dispute about the matter, the Board of Directors may itself rectify the register and there is no need to apply to the Court for rectification. The section, it may be noted, requires that only in cases where, without sufficient cause, the name of any person is entered in or omitted from the register, the person aggrieved or any member of the company or the company may apply to the court for rectification. Where there was sufficient cause for rectifying any mistake or omission, and "if there is no dispute, and if the circumstances are such that the court would order rectification" the Board of Directors may itself effect the necessary corrections. HALSBURY'S LAWS OF ENGLAND, Fourth Edn., Vol. 7, para 306, page 176: [Reissue Vol. 7(1), para 370, page 252: Vol. 7(1), 4th Edn., 1996 Reissue, para 392, p. 300]. See PALMER'S COMPANY PRECEDENTS, 17th Edn., Part I, page 1084, *In re, Pool Firebrick and Blue Clay Co., Hartley's* case, (1875) 10 Ch App 157.

In *First National Reinsurance Co. v. Greenfield,* (1921) 2 KB 260 (at 279)—. MCCARDIE, J., said "an application to the Court is only essential when the company disputes the right to rectification. There is no reason why the directors if they *bona fide* agree that a shareholder has a right to avoid the contract should not thereupon assent to the rescission of the contract and rectify the register in the appropriate manner. An order of the Court is not necessary in such a case. That was decided in *Wright's* case, (1871) 7 Ch 55 and *Rees River Silver Mining Co. v. Smith,* (1869) 4 HL 64." *Rees River's* case **relied on** in *Michaels v. Harlay House (Marylebone) Ltd.*, (1997) 3 All ER 446 : (1997) 2 BCLC 166 (Ch. D).

In *PV Damodara Reddi v. Indian National Agencies Ltd.*, (1945) 15 Comp Cas 148 : AIR 1946 Mad. 35, it was held that the register of members of a company is a public document and there is no provision in the Companies Act which permits the directors of a company or any officer of a company to make any alteration to the register by removing the names of certain members on the ground that they had been improperly added to the register. The remedy of the company is to apply to the court for the rectification of the register and not to take upon itself to alter such register. This decision, however, did not deal with the question of rectification of illegal, invalid or mistaken entries or omissions in respect of which there is no dispute.

The Board of directors do not have power to delete the names of shareholders on the ground that the stamps on transfer deeds had not been defaced. *Sayedabad Tea Co. Ltd. v. Samarendra Nath Ghattak,* (1995) 19 Corpt LA 140, 142 (Cal).

The directors have no power, however, to rectify the register by substituting the name of another person in the place of an existing member, except on an application for transfer duly made in accordance with Section 108: See *Jayantilal P. Patel v. Gordhandas Desai (P.) Ltd.*, (1968) 38 Com Cases 405 (Bom).

An unlisted public limited company will be justified in refusing to register a transfer of its shares, if the contract for sale violates the provisions of the Securities Contracts (Regulation) Act, 1956. *B.K. Holding (Pvt.) Ltd. v. Prem Chand Jute Mills Ltd.*, (1983) 53 Com Cases 367 (Cal).

Generally the protection of the court's order [now CLB] is essential to any rectification by the removal of the name of a registered holder of shares. *Derham and Allen Ltd., Re,* (1946) Ch 31, 36 : (1946) 16 Com Cases 51 (Ch D).

The sub-section, as actually worded, does not prevent rectification of the register by the company without application to CLB, if all parties concerned agree thereto and there is no controversy and no intention to defeat the provisions of any law or defraud any credi-

tors or other persons. The use of the words "may apply to the CLB" would seem to indicate that rectification otherwise than by application to CLB is not ruled out.

"Even if a company enters the name of a transferee of shares on *prima facie* evidence of a sale, the entry of the name of transferee in the share register can be challenged in an application under section 155 on the ground of illegality and fraud committed by its officers and other persons." *Turner Morrison & Co. Ltd. v. Shalimar Tar Products (1935) Ltd.*, (1980) 50 Com Cases 296 at 313 (Cal).

Full effect must be given to the words "without sufficient cause". Where in an appeal under section 111, the Central Government directed a company to register a transfer of shares, and the company entered the name of the transferee in the register of members it was held that the entry was made with sufficient cause, and the Court had no power under section 155 to override the Central Government's direction. *Arjan Singh v. Panipat Woollen & General Mills Ltd.*, (1963) 33 Com Cases 534 (Punj).

Transfer by minor's guardian.—Where a transfer was effected by the mother of a minor as his natural guardian, a petition by the father of the minor that he alone could act as a natural guardian under the law and therefore the transfers must be struck out was rejected. The CLB pointed out that if there was any thing wrong done by the petitioner's wife he should seek his remedy against her in an appropriate court. So far as the company was concerned, when properly executed transfer deeds under the signature of the minor's mother were submitted to the company and transfers effected, the petitioner could not make a grievance that the entries made in the register of members were without sufficient cause. *Jonas Hemant Bhutta v. Surgi Plast Ltd.*, (1993) 78 Com Cases 296 (CLB).

Where the matter who executed a transfer on behalf of a minor child was found by the court to be neither a natural nor *de-facto* guardian. The transfer so executed was held to be a nullity. *Mani (M.S.) v. M.S. Madhusoodanan*, (1991) 5 Corpt LA 187 (Ker—DB).

Retrospective rectification.—An order of rectification can be made retrospective to the day when the directors should have registered so as to relieve the transfer in a liquidation or to relieve him from a call. *Nation's* case, (1866) 42 Ch D 209, *Sussex Brick Co.*, (1904) 1 Ch 598; *M. Arthur v. Gulf Line*, 1909 SC 732.

Joint holders and rectification.—In the case of joint holders of shares, the stipulation is that the first named among them is entitled to attend, vote, appoint proxies, *etc.* at meetings of the company. Where the first named is unable to fulfil the functions, the other joint holders may apply for rectification of the register by making one of them as the first named. See *Burns v. Siemens Brothers Dynamo Works*, (1919) 1 Ch 225.

Rectification where partnership firm registered as member.—For Notes see under S. 41 under the heading "Whether partnership firm can be a member".

Implementation of order of rectification.—The best way of implementing the CLB's order for rectification by removal of a member's name is to strike out the member's name from the register and then add a short abstract of the CLB's order, *i.e.* "By an order of the CLB dated *etc.*, this name has been erased." *Cf. In Re, Iron Ship Bldg. Co.*, (1865) 34 Beav 597.

Power to award damages.—The Court (now CLB) has now power to award damages, besides costs, to an aggrieved party, if he has sustained any damages. But no damage can be ordered unless the relief of rectification is granted. *Praga Tools Corporation Ltd. v. M.R.M. Patny*, (1968) 38 Com Cases 175 (DB—AP); *Vidya Sagar Wadia v. Motion Pictures Asson.*, 1987 Tax LR 1792 (wrongful expulsion).

Under the repealed S. 155(2) also the court had the power to award damages, though it is necessary in such cases that the applicant should claim and prove the loss caused to him. *Ram Kishan v. Kanwar Papers (P.) Ltd.*, (1990) 69 Com Cases 209, 220 (HP).

Notes under erstwhile section 155.—The enforcement date for the repeal of sections 155 and 156 and for the absorption of Sec. 155 into Sub-sec. (4) of Sec. 111 has been announced and therefore sections 155 and 156 stand repealed. But the notes under section

155 have been retained for the sake of convenience because all pending cases have to be decided under this section. See detailed Notes under s. 155 *post.*

What is unnecessary delay [Section 111(4) and (6)]

The Act has not defined the words 'unnecessary delay'. Whether there was unnecessary or unreasonable delay has to be decided on the basis of the evidence in each case. Failure to register transfers within one month of the lodgement which is contrary to the shares listing agreement is 'unreasonable delay'. *Joseph Michael v. Travancore Rubber & Tea Co.,* (1989) 66 Com Cases 491, 501 (Ker).

Inherent Power of CLB for Restoration of petition for rectification

A petition for rectification of the register of members filed before the CLB was withdrawn under parties' consent and filed before the Special Court constituted under the Special Court (Trial of Offences Relating to Transactions in Securities) Act, 1991. The Special Court returned the petition on the finding that the date of the transaction in question was outside the jurisdiction of the Special Court. The petitioner applied to the CLB for restoration of the petition. The earlier disposal was not on merits. If the CLB did not allow restoration, no alternative forum for relief was possible. Refusal would result in failure of justice. The CLB accordingly came to the conclusion that it was a fit case for exercising inherent powers for the purpose of permitting restoration. The CLB ordered that the petition would relate back. The change of law in the meantime depriving the CLB of its jurisdiction would not affect its jurisdiction in reference to the matter in question. *Shree Cement Ltd. v. Power Grid Corpn. Ltd.,* (1998) 93 Com Cases 854 (CLB—NB).

Interim Relief [Sub-sec. (6)]

This sub-section gives power to the CLB while dealing with an application under sub-section (2) [refusal to register a transfer] or sub-section (4) [rectification of register] to grant any interim relief which the CLB may consider necessary in the circumstances of the case. It has been held that this sub-section gives wider powers to the CLB than those conferred on the courts under the Civil Procedure Code. *Manoharlal Chopra v. Rai Bahadur Rao Raja Seth Heeralal,* AIR 1962 SC 527; *Padam Sen v. State of U.P.,* AIR 1961 SC 218; *G.T. Swamy v. Good Luck Agencies,* (1990) 69 Com Cases 819 (Kant). Even though the procedure contemplated under this section is summary in nature, interim relief may be granted in proper cases. *Killick Nixon Ltd. v. Dhanraj Mills Ltd.,* (1983) 54 Com Cases 432 (Bom—DB). See also *Unit Trust of India v. Om Prakash Berlia,* (1983) 54 Com Cases 723 at 791 (Bom—DB) decided before the Companies Amendment Act of 1988.

In a case before it, the CLB noted the scope of sub-section (6) in the following words: "Under sub-section (6), the Company Law Board, while acting under sub-section (5), *viz.*, directing registration of transfer or transmission, or rectification of register of members of a company, may make such interim orders as it may deem fit and it may pass an order of injunction or stay. It may award costs. It may make incidental or consequential orders regarding payment of dividend or the allotment of bonus shares or rights shares.

The Company Law Board is, therefore, empowered to make such interim orders, including any orders as to injunction or stay while acting under sub-section (5). It may be observed that the provisions of section 111 shall apply to registration of both transfer and transmission by operation of law, of any shares and debentures in a company and rectification of the register of members in a company. Thus, on a strict interpretation it may appear that the power of injunction or stay cannot be extended beyond the scope of sub-sections (5) and (6)." Acting on these principles, the CLB directed the company, pending an appeal against its refusal to accept a transfer, that the company shall not, during the pendency of the appeal, transfer its assets because otherwise the transferee, if successful, would get the control of a barren company. *Coelho (A.J.) v. South India Tea & Coffee Estates Ltd.,* (1997) 2 Comp LJ 261 : (1998) 93 Com Cases 401 (CLB—SB).

Restriction imposed by the Company Law Board on interim basis on the transfer of shares involved in a petition under the section would cease to have effect when the matter is disposed off on merits. Accordingly, the sale of the shares in question after the main petition was disposed of was held to be not in violation of the interim restriction. *Tracstar Investments Ltd. v. Gordon Woodroffe Ltd.*, (1996) 87 Com Cases 941 (Mad—CLB).

Delay in transfer of shares, issue of allotment letters, refund, *etc.*

DCA Press Note No. 17/8/89-CL-V, dated 11-1-1991.—"Government has been receiving a number of complaints, from time to time, from shareholders/debenture-holders/investors regarding delay in transfer of shares, delay in issue of allotment letters and share/debenture certificates or refund of share/debenture application money to unsuccessful applicants of public issue.

2. Attention of companies is invited to the following provisions of the Companies Act, 1956, as also the Listing Guidelines, *etc.* issued in this regard:

(a) Under section 113 of the Companies Act, 1956, every company shall, within 3 months, after allotment of any shares/debentures and within 2 months after the application for registration of transfer of such shares/debentures, deliver the certificates of all shares/debentures allotted or transferred. Any default in compliance of these provisions of law is punishable.

(b) As per the Listing Guidelines which are applicable to companies listed on Stock Exchanges, allotment letters or share certificates must be issued to the allottee immediately after the allotment of shares is made, but not later than 2 months from the date of the closure of the subscription list. Letters of regret, together with the refund order, will also be issued simultaneously.

(c) As per Listing Agreements entered into by listed companies with Stock Exchanges, a company is required to issue share certificate within one month of the date of lodgement of transfer of shares.

(d) Under section 111 of the Companies Act, 1956, if a company refuses to register any transfer of shares, it shall, within 2 months, send notice of refusal to the transferee and the transferor and it is open to the aggrieved transferee/transferor to file an appeal before the Company Law Board.

(e) Under section 22A of the Securities Contracts (Regulation) Act, 1956*, in case of a company whose shares are listed on a stock exchange, the company may refuse to register the transfer of shares on one or more of the following grounds:—

(i) that the instrument of transfer is not proper or has not been duly stamped and executed or that the certificate relating to the security has not been delivered to the company or that any other requirement under the law relating to registration of such transfer has not been complied with;

(ii) that the transfer of the security is in contravention of any law;

(iii) that the transfer of the security is likely to result in such change in the composition of the Board of Directors as would be prejudicial to the interests of the company or to the public interest; and

(iv) that the transfer of the security is prohibited by any order of any court, tribunal or other authority under any law for the time being in force.

However, before communicating refusal to transfer shares on the grounds specified at (ii), (iii) and (iv) above, the company has to make a reference to the Company Law Board for confirmation, within 60 days of the lodgement of the instrument of transfer.

(f) Section 73 of the Companies Act, 1956, and the Listing Guidelines which are applicable to companies listed on Stock Exchanges provide for a maximum time-limit of 10 weeks from the close of the subscription list for public issue, for despatch of allotment letters/certificates as to shares and debentures and refunds to unsuccessful applicants, companies entering the capital market are required to pay to the unsuccessful applicants, interests up to a maximum rate of 15 per cent p.a. for delayed period beyond 10 weeks from the date of close of the subscription list.

(g) As per *Circular No.* 8/15/SE/86-B, dated 3-6-1986, issued by the Ministry of Finance, Department of Economic Affairs, (Stock Exchange Division), North Block, New Delhi, all companies listed/seeking enrolment on stock exchanges, shall issue refund orders, allotment letters/certificates only by registered post.

3. Complaints have also been received against non-payment and delay in payment of interest on debentures or on redemption of debentures. Such complainants may approach the trustees of the debenture

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* Since *Omitted*.

trust fund, in whose favour the assets of the company are mortgaged, for enforcing the security created for the purpose.

4. In regard to non-compliance of the provisions of the Companies Act, 1956 and section 22A of the Securities Contracts (Regulation) Act, 1956, shareholder can take up the matter with the concerned Registrar of Companies and in regard to non-compliance of Listing Guidelines/Listing Agreement/Circular issued by Department of Economic Affairs, a reference may be made to the concerned Stock Exchange(s)/Department of Economic Affairs. Section 621 of the Companies Act, 1956 also authorises a shareholder to file prosecution against the company and its officers. The companies concerned are advised to ensure that delays and non-compliance of provisions of the Companies Act, Listing Guidelines, *etc.* are avoided, failing which proceedings will be initiated against them in accordance with law."

Jurisdiction for Investor Guidance, Grievances and Complaints

Non receipt of Share Certificates after transfer/transmission.—A complaint lies before the SEBI Forum. For the format of the complaint and addresses of the forum, see *Appendix* 234.

Period of limitation [Sub-section (4)]

It has been held that the period of limitation for filing a suit for rectification is governed by Art 113 of the Limitation Act, 1963 (corresponding to Article 120 of the Limitation Act, 1908). *Sha Mulchand & Co. Ltd. v. Jawahar Mills Ltd.,* (1953) 23 Com Cases 1 : AIR 1953 SC 98; *Balwant Singh (S.) v. Krishna Bus Service (P.) Ltd.,* (1967) 37 Com Cases 471 (Del); *Navinchandra Ratilal Patel v. Gordhandas Desai (Pvt.) Ltd.,* (1967) 37 Com Cases 747 (Bom). See also *Mahadeo Lal Agarwala v. New Darjeeling Union Tea Co. Ltd.,* AIR 1952 Cal 58. For petitions under this section Art. 137 of the Limitation Act, 1963, has been held applicable. *Anil Gupta v. Delhi Cloth & General Mills Co. Ltd.,* (1983) 54 Com Cases 301 (Del). But see *Moni Mohan Mukherjee v. Jalpaiguri Cinema Co. Ltd.,* 1975 Tax LR 1741 : 79 CWN 512 and *Kotah Transport Ltd. v. State of Rajasthan,* (1967) 37 Com Cases 288 : AIR 1966 Raj 136, where it has been held that there is no provision of the Limitation Act which applies to applications under this section. It is submitted that this view is incorrect. If no limitation applies, then it would mean that rectification could be asked for even 20 years after the removal or insertion of a name in the register of members.

Though the Limitation Act is not applicable, a petition may be rejected if it suffers from unexplained long delay, laches, acquiescence, which may show waiver or estoppel. *Nupur Mitra v. Basubani P. Ltd.,* (2001) 3 Comp LJ 244 : (2001) 41 CLA 306 : (2001) 31 SCL 1 : (2001) CLC 1102 (CLB—WB). The Eastern Region Bench of the CLB held in *Khurshid Alam v. P. Pagnon Co. P. Ltd.,* (2002) 108 Com Cases 523 : (2001) 45 CLA 392 (CLB) that the Limitation Act was applicable and, therefore, delay, if any, could be condoned. Time was lost in this case in *bona fide* pursuit of other remedies to settle questions of title to shares. *Canara Bank v. National Power Grid Corpn. Ltd.,* (2003) 48 SCL 543 : (2004) 58 CLA 54 (CLB), period of limitation not applicable for petition under sub-s. (4).

It has been held that the period of 4 months from the date of lodgement of transfer documents as prescribed by sub-s. (2) is not applicable to a petition under sub-s. (4). Two remedies are provided by the same section and in the same Forum. One is against refusal to accept a transfer of shares, *etc.*, and provides a period of four months for taking action. The other is for rectification of register of members, expressly including the matter of refusal to accept a transfer of shares, *etc.*, and this provides no period of limitation. Hence, three years period was available. This was the position under the erstwhile S. 155 before its repeal and transfer to S. 111(4) by the amendment of 1988. Under that section proceedings could be only in a court. But now they are before the CLB and the CLB, being not a court, no period is applicable. *Citi Bank NA v. Power Grid Corpn. of India Ltd.,* (1995) 83 Com Cases 454 (CLB—NB).

It has again been held in *Shiv Dayal Agarwal v. Sidhartha Polyster P. Ltd.,* (1996) 88 Com Cases 705 (CLB—NB); *Shukla Mahajan (Smt.) v. Sidhartha Polyster P. Ltd.,* (1996) 88 Com Cases 705 that the periods of limitation set out in sub-s. (3) are not appli-

cable to a petition under sub-s. (4). The CLB laid down that the Limitation Act, 1963 is also not applicable to proceedings under sub-s. (4). The dispute in this case was denial of allotment to a person who was eligible and also had the right to get his promoters' quota, but he was excluded. The count-down was to begin from the date of allotment and going by that date the CLB found that even if the Limitation Act was applicable, the petition was within time. While three year period from the date of cause of action would be applicable when the matter is to be taken up before the court, no period of limitation is applicable for proceedings before the CLB. See also *Ramanika Silks P. Ltd. v. J.C. Augustine,* (1999) 1 Comp LJ 337 : (1999) 32 CLA 141 (CLB–SB).

The same was the view of the CLB in *A.V. Sampat, OL, BoB Fiscal Services P. Ltd. v. Dunlop India Ltd.,* (1996) 87 Com Cases 398 (CLB—Cal). This view was based on the fact that the Limitation Act, 1963 is applicable to court proceedings and the Company Law Board is not a court for this purpose. Hence, Article 137 of the Limitation Act which provides omnibus limitation period of three years does not have application to proceedings before the Company Law Board. *Kana Sen v. C.K. Sen & Co. P. Ltd.,* (1997) 4 CLJ 468 : (1997) 27 CLA 82 (CLB—Cal). See also *Nupur Mitra v. Basubani P. Ltd.,* (1999) 35 CLA 97 (Cal) where the court observed that the question of the application of the Limitation Act was immaterial because even if it did apply, the power of condonation under s. 5 of that Act would have been attracted.

The ruling in *Nupur Mitra,* (Supra) was followed in *Bombay Dyeing & Mfg. Co. Ltd. v. Arun Kumar Bajoria,* (2001) 4 Comp LJ 115 : (2001) 107 Com Cases 535 (CLB). In regard to the application of this section, the law as propounded by the Supreme Court in a number of cases is that the term 'sufficient cause' must be given liberal construction so as to advance substantial justice. Delays in bringing the appeal are required to be condoned in the interest of justice, where no gross negligence or deliberate inaction or lack of *bona fides* is imputable to the parties seeking condonation of delay. The CLB applied *Rame Gowda (G.) v. Land Acquisition Officer,* AIR 1988 SC 897.

Where rectification of the register of members was sought some eight years after the alleged allotment of shares, the court rejected the petition because of the bar of time and also because of other complicated questions of fact surrounding the allotment. *Jagjit Rai Maini v. Punjab Machinery Works P. Ltd.,* (1995) 4 Comp LJ 110 : (1995) 18 CLA 169 : (1995) 6 SCC 117 : (2001) 103 Com Cases 979 (P&H).

The Madras Bench of the Company Law Board has held that the specified periods applicable to proceedings under S. 111(1) do not apply to an application for rectification of the register of members under section 111(4) and that no other period of time is also applicable. *T.G. Veera Prasad v. Sree Rayalseema Alkalies & Allied Chemicals Ltd.,* (1997) 89 Com Cases 13; *G.N. Bayra Reddy v. Arathi Cine Enterprises (P.) Ltd.,* (1997) 89 Com Cases 745 (CLB—Mad); *Naveen Kumar v. Karanataka Theatres Ltd.,* (1998) 93 Com Cases 443 : (1998) 3 Comp LJ 468 : (1998) 31 CLA 394 (Kant), under s. 155 [new s. 111(4)] when the appeal lay before the High Court or the Central Government at choice, three years period was held to be applicable where the application was to the High Court. The petition in this case was filed within one year of refusal and, therefore, was held to be within time.

Where the matter was before the High Court and the application for rectification was filed six years beyond the period of limitation and no ground for condonation, such as, fraud or mistake was shown to have been there, the petition was held liable to be dismissed. *Bipin Vadilal Mehta v. Ramesh B. Desai,* (1998) 92 Com Cases 910 : (1997) 1 Comp LJ 110 (Guj). The matter of limitation would have to be considered first before going into merits. The question of limitation cannot be avoided by branding the transaction as void. A wrong entry in a register of members is not a continuing wrong (*ibid*). The court applied the principle enunciated by the Privy Council in *Bal Gangadhar Tilak v. Srinivas Pandit,* AIR 1915 PC 7 to the effect that particulars of fraud must be pleaded.

Where a civil suit was dismissed because of time bar and the CLB was then approached after a period of about 11 years, it was held that it would not be proper for the CLB to reopen the issue at that late stage. *Narayana Aiyer (K.S.) v. Talayar Tea Co. Ltd.*, (1995) Law Weekly 42 (Mad).

Court sale of shares [Sub-section (11)]

Where a person had purchased the shares of a private company under a court auction and the company was not registering the shares in the name of the purchaser, the CLB held that the action of the company was not justified and the company was accordingly directed to register the transfer within the time prescribed by section 111(5). *K. Subramania Iyer v. New Look Rubbers P. Ltd.*, (1989) 3 Comp LJ 242 (CLB); *F. Narankari Motor Co. v. Wahid Bus and Mailsi Transport Co.*, (1947) 17 Com Cases 182 (Lah).

The articles of a private company contained a provision prohibiting transfer to non-members. It was held that an auction sale of the company's shares did not have the effect of removing the prohibition. The Board of directors retained the right to refuse registration of the transfer. *S.A. Padmanabha Rao v. Union Theatres P. Ltd.*, (2002) 108 Com Cases 108 : (2002) 1 Comp LJ 294 : (2002) 46 CLA 66 : 2001 CLC 88 (Kant). The Company Law Board can, in such cases, order the return of the purchaser's price or compensation for his loss, failing which the company may be ordered to effect registration of the transfer.

§ See also Notes under s. 108 under the heading "Registration of Transfer under Orders of Court/CLB".

Dispute between public sector corporations

A dispute between public sector corporations as to in whose names the mutual funds bonds of public sector companies are to be registered is to be considered by the Committee of Secretaries. *National Thermal Power Coprn. v. Canara Bank*, (1999) 97 Com Cases 930 : (1999) 22 SCL 119 : (2000) CLC 751 : (2000) 37 CLA 328 (Delhi). This decision was **reversed** by the Supreme Court in *Canara Bank v. National Thermal Power Corpn.*, (2001) 104 Com Cases 97 : (2001) 1 Comp LJ 224 (SC) on the ground that the trustee of the mutual fund was not a Government undertaking and, therefore, it was not a case of a dispute between two Government undertakings.

Special Court (Trial of Offences Relating to Transactions in Securities) Act, 1992

In a matter before the Supreme Court, *Minoo Mehta v. Shavak D. Mehta*, (1998) 91 Com Cases 895 (SC), the complaint alleged that the shares in question were handed over to the accused for sale but, the accused, though he sold off the shares, did not remit the proceeds to the owner. The alleged offence related to transactions in securities within the meaning of the above Act. The court accordingly held that the offence was to be tried by the Special Court and not the criminal court.

Transactions relating to securities involving notified persons have to come before the Special Court. *Rahul Subodh Windoors Ltd. v. A.K. Menson*, (1999) 22 SCL 188 : (1999) 96 Com Cases 597 : (1999) 4 SCC 446 : AIR 1999 SC 1675.

Special court not subordinate to High Court.—The High Court has no administrative superintendence over the special court. It cannot order the transfer of a case from one judge of the court to another. *Dhyan Investments and Trading Co. Ltd. v. CBI*, (2001) 107 Com Cases 1 (SC).

Consent orders.—The Supreme Court held in *Western Press P. Ltd. v. Custodian*, (2001) 1 Comp LJ 231 (SC) that consent orders of the Special Court could not be faulted with particularly when they were based upon the existence of certain facts as shown by representations made before it. The parties making the representations were not allowed to wriggle out of them.

Special Court Act prevails over SICA.—The provisions of the Special Court (Trial of Offences Relating to Transactions in Securities) Act, 1992 prevail over those of Sick In-

dustrial Companies (Special Provisions) Act, 1985. *Solidaire India Ltd. v. Fairgrowth Financial Services Ltd.*, (2001) 1 Comp LJ 400 : (2001) 104 Com Cases 569 : (2001) 3 SCC 59 (SC).

Special Court (Jurisdiction in time-period).—The jurisdiction of the Court is not limited to offences committed between 1-4-1991 and on or before 6-6-1992. The period specified in s. 3(2) relates to transaction in securities and not to an offence. *Hiten P. Dalal v. Bratindranath Banerjee,* (2001) CLC 1646.

Costs of litigation arising out of wrongful refusal

It has been observed that the court today is more ready than in former times to examine the true nature of the dispute between the parties and to make the order of costs to reflex that. The question before the court was that where the directors of a company refuse to register a transfer of shares and their decision is found wrong and they are compelled to register, the costs of the applicant would have to be paid by the company or the directors who resorted to an unsustainable decision. The case was *Morgan v. Morgan Insurance Brokers Ltd.*, (1993) BCLC 676 (Ch D). The facts were that a 76% shareholder was virtually nullified because of the 11 shareholders of the company, ten were directors and at Board meetings he had just only one vote. He was not able to requisition a meeting because he alone would not constitute a valid meeting. He transferred one share to his daughter to enable him to requisition a meeting but the directors refused to approve the transfer. He applied for rectification. The directors compromised because on legal advice they were told that they had no right to reject under the articles. The question was that of the petitioner's costs. It was held that an application for rectification is against the company and it is not necessary to join the directors as a party unless it was sought to make them liable for costs. Here in this case the position was that a majority shareholder was blocked by the Board from exercising the voting power to which his shareholding entitled him and in blocking him the directors were acting beyond their powers. Thus he had a strong case for an order of costs against the directors and it was not necessary for him to establish bad faith before obtaining such order. By analogy with costs of unfair prejudice petition where the courts are very ready to make an order against individual shareholders who act unfairly, so too in this case it would be unjust to the majority shareholder to order the company to pay his costs. Accordingly, the costs were awarded against the individuals who were directors.

Penalty for default [Sub-sections (9)/(12)]

Under sub-section (9), if default is made in giving effect to the orders of the Tribunal under this section, the offence is punishable with fine till the default continues. The said default may relate to the order for rectification of register of members and payment of damages under sub-section (5); interim orders as to stay or injunction, award of costs, payment of dividend, allotment of bonus or rights shares; or order directing the company to register transmission of shares, by way of sale held by Court or other public authority, by a member of the company, under sub-section (11).

Under sub-section (12), if default is made in complying with any provisions of this section, the offence is punishable with fine till the default continues. The said default may relate to the delay in sending notice of the refusal or not giving reasons for such refusal, under sub-section (1).

Unlike sub-section (3) under which appeal can be filed within 2 months of the notice of refusal or where no notice has been sent for refusal, within 4 months from the date when transfer was lodged, no period of limitation has been prescribed in sub-section (4) for filing an application for rectification of the register.

Where a complaint did not even mention the fact of default beyond two months, nor alleged other matters which constitute the ingredients of the offence, the process issued by the court below was quashed. *Karnataka Theatres Ltd. v. S. Venkatesan,* (1989) 66 Com Cases 679 (Kant). A wrong entry in a register of members is not a continuing

wrong. *Bipin Vadilal Mehta v. Ramesh B. Desai,* (1998) 92 Com Cases 910 : (1997) 1 Comp LJ 110 (Guj).

Compoundable offence.—It may be noted that the offences under sub-sections (9) and (12) are compoundable under section 621A.

Appeal against orders of Company Law Board

The orders passed by the Company Law Board under this section are appealable to the High Court on any question of law under section 10F.

On the enforcement of the Companies (Second Amendment) Act, 2002 the power of the CLB will be transferred to be Tribunal. An appeal against any decision of the Tribunal will lie before the Appellate Tribunal under section 10FQ.

Under the repealed S.155(4) appeals were allowed only on questions of law. It has been held under that section that the failure to formulate a substantial question of law is not a defect in the memorandum of appeal. *Mathew Michael v. Tekoy (India) Ltd.,* (1990) 69 Com Cases 145, 151 (Ker–DB), **affirming** (1983) 54 Com Cases 88 (Ker). A question of law arising out of the findings in the judgment of the Companies Tribunal (since abolished) was allowed to be raised for the first time in an appeal under section 10-D(1)(b) of the Companies Act, [omitted] 1956 although that question of law had neither been raised before nor dealt with by the Tribunal in its judgment or order. *Metal Press Works Ltd. v. Ram Prasad Kayan,* (1967-68) 72 CWN 594, 599 (Cal).

The company refused a transfer without stating any reasons. The Company Law Board did not give any opportunity to the company for stating its reasons. The order of the High Court directing the company to register the transfer became bad. The court could have directed the CLB to reconsider the matter, but because of the long pendency of litigation, the Supreme Court ordered as follows: "Instead of remanding the matter back to the Company Law Board, the more appropriate course would be to keep the appeals pending here and call for a remand report from the Company Law Board. We, therefore, direct the company to examine the applications of the respondents for transfer of shares and give their decision on merits whether agreeing to transfer or refusing to register the transfer. They should record their reasons if they decide to reject the applications and submit a report of their decision to the Board with their reasons. After obtaining the report of Board of directors, the Company Law Board will dispose of the appeals filed before them afresh on the merits in accordance with law, in the light of the report of reasons received from the Board of directors and the company and after hearing both parties." *Talayar Tea Co. Ltd. v. Union of India,* 1992 Supp (3) SCC 38.

Appeals under erstwhile section 155(4).—The position of appeals under erstwhile s. 155(4) as it crystalised in few cases was as follows: The words 'Bench of the High Court' mean a bench of two judges excluding the judge whose order is appealed against. *Upendra Kumar Joshi v. Kesoram Industries & Cotton Mills Ltd.,* (1983) 54 Com Cases 1 (Pat—FB). **Followed** in *Upendra Kumar Joshi v. New Victoria Mills Co. Ltd.,* (1986) 59 Com Cases 798 (Pat–FB). See also *Joseph Michael v. Travancore Rubber & Tea Co. Ltd.,* (1986) 59 Com Cases 898 (Ker–DB). The Allahabad High Court had held that an appeal can lie under sub-section (4) only when there is a final order under Sub-section (2). Where the court merely granted an interlocutory injunction to stay the exercise of rights by a shareholder, an appeal would not lie under this section but under the High Court Rules, *Somani (K.K.) v. Somani (D.K.),* (1986) 59 Com Cases 910 (All–DB).

An order of the Central Government passed in appeal under section 111 had been held not to debar the making of an application under this section. *Sadashiv Shanker Dandige v. The Gandhi Seva Samaj Ltd.,* AIR 1958 Bom 247 : (1958) 28 Com Cases 137; *Nazamunnessa Begum v. Vidyasagar Cotton Mills Ltd.,* (1963) 33 Com Cases 36: AIR 1962 Cal 380; *Moni Mohan Mukherjee v. Jalpaiguri Co. Ltd.,* 1975 Tax LR 1741 (Cal).

Nature of Central Government's appellate powers (now vested in CLB)

It was held by the Supreme Court that the Central Government in exercising its powers under this section was acting as a tribunal exercising judicial functions. The proceedings had all the trappings of a judicial tribunal. Pleadings had to be filed, evidence in support of the case of each party had to be furnished and the disputes had to be decided according to law after considering the representations made by the parties. "As the dispute between the parties related to the civil rights and the Act provided for a right of appeal and made detailed provisions about hearing and disposal according to law, it was impossible to avoid the inference that a duty was imposed upon the Central Government in deciding the appeal to act judicially." The court further held that the very nature of the jurisdiction required that it was to be exercised subject to the same limitations which applied to the Court under S. 155. *Harinagar Sugar Mills Ltd. v. Shyam Sunder Jhunjhunwala,* (1961) 31 Com Cases 387 : AIR 1961 SC 1669. The powers exercised under this section being judicial, any finding of fact was not to be reopened by the Supreme Court. *Amalgamated Electricity Company Ltd. v. Naval Sorabjee Bhathena,* (1963) 33 Com Cases 568 (SC).

Position of transferee, if his appeal fails

The ordinary result of a refusal to register a transfer of shares is that the transferor will be the trustee for the transferee, in respect of the rights relating to the shares. *Mathalone (R) v. Bombay Life Assurance Co. Ltd.,* (1954) 24 Com Cases 1 : AIR 1953 SC 385. See also *Hawks v. McArthur,* (1951) 1 All ER 22 (Ch D) and *Jaluram Bhikulal Firm of Itwara v. I.T. Commissioners,* (1953) 23 Com Cases 103 : AIR 1953 Nag 77. Or, if the transferee so chooses, he may sue the transferor for return of the consideration for the transfer under section 65 of the Contract Act. Where a transfer of shares is not registered, position of the transferee is that of a beneficial owner of the shares, while the transferor continues to be the legal owner thereof.

Petition before CLB

An appeal under sub-section (2) or an application under sub-section (4) may be made by way of a petition to the concerned double member Bench of the Company Law Board as per procedure laid down in CLB Regulations, 1991, along with a fee of Rs. 500/- and accompanied by the following documents:

Where the company is petitioner

(1) Copy of the memorandum and articles of association.
(2) Latest audited balance-sheet and profit and loss account, auditors' report and directors' report.
(3) Authenticated copy of the extract of the Registrar of members.
(4) Copy of the resolution of the Board or Committee of Directors (where applicable).
(5) Any other relevant documents.
(6) Affidavit verifying the petition.
(7) Bank draft evidencing payment of application fee.
(8) Memorandum of appearance in Form No. 5 of Annexure I with copy of the Board Resolution or the executed Vakalatnama, as the case may be.
(9) Two extra copies of the petition.

Where the petition is made by any other person

(1) Documentary evidence in support of the Statement made in the petition including the copy of the letter written by the petitioner to the company for the purpose of registering the transfer of, or the transmission of the right to any shares or interest in, or debentures as also a copy of the letter of refusal of the company.
(2) Copies of the documents returned by the company.

(3) Any other relevant documents.
(4) Affidavit verifying the petition.
(5) Bank draft evidencing payment of application fee.
(6) Memorandum of appearance in Form No. 5 of Annexure I with a copy of the Board's resolution or the executed Vakalatnama, as the case may be.
(7) Two extra copies of the petition.

§ For text of the Company Law Board Regulations, 1991, refer *Appendix* 3.

ICSI Guidance Note on Compliance Certificate (August, 2003)

The ICSI has issued a Check List for issue of Compliance Certificate under proviso to Sec. 383A(1) in respect of maintenance of registers. The relevant paragraph 1 of the Form prescribed under Rule 3 of the Companies (Compliance Certificate) Rules, 2001 states :

***"Paragraph 1.*— The company has kept and maintained all registers as stated in Annexure "A' to this certificate, as per the provisions and the rules made thereunder and all entries therein have been duly recorded."**

Register of Transfers [*Item (e) of 'Other Registers'*]

Prescribed Check List.—The register is optional register and should be maintained as good secretarial practice. However, if the register is not maintained, the CSP should not qualify his certificate.

Check whether:

(i) The company has maintained separate register of transfers for different classes of shares/debentures, and entered therein the particulars relating to the registration of transfer of shares/debentures;
(ii) transfer number as per the register of transfer and date of approval has been entered in the Share Transfer Deed in Form 7B;
(iii) the Company has maintained a separate file of documents like Powers of Attorney, Probate, Letters of Administration and/or Succession Certificate, Resolution of companies or other bodies corporate authorising any particular person(s) to sign on its behalf that are registered with the company; and
(iv) details of nomination forms have been noted.

§ For the text of the Companies (Compliance Certificate) Rules, 2001, see *Appendix* 38.

§ For the full text of the Guidance Notes on Compliance Certificate and for Specimen Compliance Certificate Form as issued by ICSI see *Appendix* 312.

[1][**S. 111A. Rectifications of register on transfer.**—(1) In this section, unless the context otherwise requires, 'company' means a company other than a company referred to in sub-section (14) of section 111 of this Act.

(2) Subject to the provisions of this section, the shares or debentures and any interest therein of a company shall be freely transferable:

[2][*Provided* that if a company without sufficient cause refuses to register transfer of shares within two months from the date on which the instrument of transfer or the intimation of transfer, as the case may be, is delivered to the company, the

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1. Ins. by the Depositories Act, 1996 (w.e.f. 20-9-1995).
2. Ins. by the Depositories Related Laws (Amendment) Act, 1997 (w.e.f. 15-1-1997).

transferee may appeal[3] to the [4][*Tribunal*] and it shall direct such company to register the transfer of shares].

[5][(3) The [4][*Tribunal*] may, on an application[3] made by a depository, company, participant or investor or the Securities Exchange Board of India, if the transfer of shares or debentures is in contravention of any of the provisions of the Securities and Exchange Board of India Act, 1992 (15 of 1992), or regulations made thereunder or the Sick Industrial Companies (Special Provisions) Act, 1985 (1 of 1986), or any other law for the time being in force, within two months from the date of transfer of any shares or debentures held by a depository or from the date on which the instrument of transfer or the intimation of the transmission was delivered to the company, as the case may be, after such inquiry as it thinks fit, direct any depository or company to rectify its register or records.]

(4) The [4][*Tribunal*] while acting under sub-section (3), may at its discretion make such interim order as to suspend the voting rights before making or completing such enquiry.

(5) The provisions of this section shall not restrict the right of a holder of shares or debentures, to transfer such shares or debentures and any person acquiring such shares or debentures shall be entitled to voting rights unless the voting rights have been suspended by an order of the [4][*Tribunal*].

(6) Notwithstanding anything contained in this section any further transfer during the pendency of the application with the [4][*Tribunal*], of shares or debentures shall entitle the transferee to voting rights unless the voting rights in respect of such transferee have also been suspended.

(7) The provisions of sub-section (5), (7), (9), (10) and (12) of section 111 shall so far as may be, apply to the proceedings before the [4][*Tribunal*] under this section as they apply to the proceedings under that section.]

NOTES

General Note : As and when the Companies (Second Amendment) Act, 2002 (11 of 2003) comes into force, the power under this section shall become transferred to the Tribunal to be exercised by it in place of the Company Law Board. The commentary should be read keeping this change in mind.

Historical Background

Originally, two remedies were available to the aggrieved transferor/transferee in respect of transfer/transmission of shares in, or debentures of, a public or a private company—to file an appeal before the Central Government under section 111 (power delegated to CLB) or to apply to High Court under section 155 for rectification of register of members/debentureholders. A new section 22A was inserted in the Securities Contracts (Regulation) Act, 1956 (w.e.f. 17-1-1986) to provide that shares of a listed company shall be freely transferable and it may refuse transfer of its securities only on four specified grounds. It was also provided that while the company could refuse by itself if the instrument of transfer was not properly executed or stamped; before refusing transfer on other grounds it had to seek confirmation of CLB within 2 months from the date of lodgement of instrument of transfer.

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3. With fee of Rs. 500/- under CLB (Fees on Application & Petitions) Rules, 1991. See *Appendix* 6
4. Subs. for "Company Law Board", by the Companies (Second Amendment) Act, 2002 (11 of 2003), s. 15.
5. Subs. by the Depositories Related Laws (Amendment) Act, 1997 (w.e.f. 15-1-1997).

Depositories Act, 1996

Substantial changes have been made in the Companies Act, 1956 by the Depositories Act, 1996 (w.e.f. 20-9-1995, being the date of promulgation of Ordinance). As per sub-section (14) inserted in section 111 by that Act, it is provided that 'company' means a private company and also a private company which has become a public company under section 43A. Further, section 111A has been inserted to provide for free transferability of shares or debentures of a public company [sub-section (2)], other than a private company or section 43A company [sub-section (1)]. CLB has been empowered to direct rectification of register of members or records of a depository in case a transfer has been made in contravention of the provisions of SEBI Act, 1992 or Sick Industrial Companies (Special Provisions) Act, 1985, on an application made by a depository, company, participant, investor or SEBI [Sub-section (3)]. These changes have been made with a view to deal with transfers through depositories and to ensure free transferability of shares and debentures. Simultaneously, section 22A of SCR Act was omitted.

Depositories Related Laws (Amendment) Act, 1997

Although section 111A(2) provided that "subject to the provisions of this section, the shares or debentures or any interest therein of a company shall be freely transferable", yet there was no provision to apply to the CLB in case of refusal or delay in registration of transfer or rectification of register of members. This omission was corrected by the Depositories Related Laws (Amendment) Act, 1997 by which a proviso was added to sub-section (2) of section 111A to the effect that in case a public company, without sufficient cause, refuses to register a transfer, the transferee may move CLB for relief. Changes have also been made in sub-section (3) of section 111A by the Amendment Act, 1997 by addition of the words "or any other law for the time being in force" so as to include contravention of the provisions of the Companies Act, 1956, Securities Contracts (Regulation) Act, 1956 and other applicable laws.

The Depositories Act, 1996 provides for establishment of one or more depositories, entrusted with the responsibility of maintaining ownership records of securities in a book entry form. The said Act provides for dematerialisation of shares in the depository mode under which the securities held in a depository shall be reflected through book entry through computerised electronic data, without physical delivery of share certificates transfer deeds, *etc.* Consequential changes have been made in the Companies Act, in this regard. The provisions of section 108 shall not apply to transfers effected through a depository. These provisions will, however, apply to transfers made outside the depository mode in case of non-listed public companies and such listed public companies which opts out of the depository mode.

Retrospective effect of Depositories (Amendment) Act, 1997.—The decision of the Company Law Board in *Trade Links Ltd. v. Mount Shivalik Breweries Ltd.,* (1999) 95 Com Cases 150 : (1999) 32 CLA 423 : (1998) 18 SCL 110 : (2000) 6 Comp LJ 526 (CLB—NB) examines whether the amendment would have retrospective effect. In reference to the rectification of the Register of Members of public companies s. 111A permits only three grounds for the purpose. The third ground was added by the amendment. It enables the CLB to order rectification where the refusal of the company to register a transfer was in violation of any law for the time being in force. The amendment is of remedial nature. Therefore, the CLB was of the view in this case that the amendment would have retrospective application. The CLB was approached for an order of restoration of the name of a shareholder in the company's Register of Members because the deletion of the name was without sufficient cause and for a dubious purpose. At the time of the petition this power was not there in the CLB. During the pendency of the petition, the amendment came into force and the CLB became revested with the power to order rectification of the Register if there is violation of any law for the time being in force. The earlier position was also the same. The chance omission of the power without any intention to do so was rectified by the amendment. Thus the amendment was of clarificatory nature. To give it

retrospective effect would not do any violence to the objectives of the Depositories Act or the Companies Act. On the contrary, this approach would ensure the proper use of the machinery for grievance redressal. On the facts of the case, however, no violation of any law could be proved in the matter of the registration of the shares in question. Whether the amendment was retrospective or not would not have affected the decision on facts.

Companies (Second Amendment) Act, 2002 [11 of 2003]

The powers of the Company Law Board under this section have been conferred on the Tribunal constituted under Part 1B of the Act. Consequential changes have accordingly been made in the section. Notes on Clauses of the Bill stated thus:

Notes on Clause.—This clause seeks to amend sections 111, 111A, 113, 117B, 117C and 118 of the Companies Act, 1956 relating to power to refuse registration of transfer of shares or interest of a Member or debentures and appeal against such refusal, rectification of register on transfer, limitation of time for issue of certificates, appointment of debenture trustees and duties of debenture trustees, liability of company to create security and debenture redemption reserve and right to obtain copies of and inspect trust deed. The Company Law Board has been conferred upon certain powers under these sections. It is proposed to confer these powers of the Company Law Board upon the Tribunal. These amendments are of consequential nature. (*Clause* 14 of the Companies (Amendment) Bill, 2001).

No right to refuse transfer of dematerialised shares

The Depositories Act, 1996 has inserted section 152A which deems the register and index of beneficial owners maintained by a depository as an index of members for the purposes of the Act. Transfer of shares are registered by the depository and periodic intimation sent to the company. The company would, therefore, come to know of the registration of a transfer only *post facto*. The remedy of the company is to apply to the Company Law Board seeking an order for rectificaiton of its register of members by deleting the transfer registered by the depository.

Delegation of Board's power relating to transfer of shares by listed companies

Kumarmangalam Committee Report*.—Pursuant to the recommendaitons of the Kumarmangalam Birla Committee on 'Corporate Governance', SEBI has directed incorporation of certain matters in the Listing Agreement as clause 49 [*No. SMDRP/Policy/Cir-10/2000, dated 21-2-2000 addressed to all Stock Exchanges*].

Clause 49-VI(D) provides for delegation of Board's power relating to transfer of shares and reads as follows:

The company further agrees that to expedite the process of share transfers the board of the company shall delegate the power of share transfer to an officer or a committee or to the registrar and share transfer agents. The delegated authority shall attend to share transfer formalities at least once in a fortnight.

Scope of section

This section relates to transfer of shares or debentures in respect of a public company and provides for free transferability of its shares or debentures. As per proviso to sub-section (2), an aggrieved transferee may seek remedy by filing an appeal before CLB if transfer is refused without sufficient cause within 2 months from the date of lodgement. Proviso to sub-section (2) does not provide for any period of limitation for filing an appeal. In contrast, section 111(3) provides for filing an appeal, in case of a private company, within 2 months from the date of receipt of notice of refusal or within 4 months from the date of lodgement where no notice of refusal has been sent by a private company. In the absence of any period prescribed for filing an appeal, the same may be filed

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* For text of the Kumarmaglam Report, see *Appendix* 256.

without any bar of limitation as in the case of making an application under section 111(4) for rectification.

It has been held that the word "may" in s. 111A(3) has to be considered as "shall", *Bombay Dyeing and Mfg. Co. Ltd. v. Arun Kumar Bajoria,* (2001) 4 Comp LJ 115 : (2001) 44 CLA 232 : (2001) 107 Com Cases 535 (CLB). [Sub-section (3) of section 111A relates to rectification of register of members or record of depository in case any transfer is made in contravention of the provisions of SEBI Act, 1992 or Regulations made under that Act, or Sick Industrial Companies (Special Provisions) Act, 1985 or any other law, on an application being made by the aggrieved depository, company, participant or investor or SEBI within 2 months from the date of transfer]. Application filed beyond the prescribed period of two months will be time barred. CLB is also empowered to pass interim orders regarding exercise of voting rights on impugned shares pending final hearing of the application.

Where by the time the petition was filed under s. 111, the private company had become a public company, the petition was taken to have been filed under s. 111A. *Shailesh Rajnikant Parekh v. Starline Travels P. Ltd.,* (2004) 118 Com Cases 145 (CLB).

Default in payment of share money

The allottee whose name was entered in the register of members made payment by means of a cheque which was dishonoured. The register was allowed to be rectified by deleting his name. *Comp U-Learn Tech. India Ltd. v. BRS Chowdhary,* (2003) 42 SCL 746 (CLB—Chennai).

"Sufficient Cause"

Invalid and unauthorised transfer.—Section 111A(3) empowers the Company Law Board to order rectification of the register of members by directing the removal of a registration only on three grounds specified in the sub-section. This constitutes the post-registration power of CLB. The proviso to sub-section (2) deals with the power to order registration (pre-registration power) of a transfer where it has been refused by the company "without sufficient cause". One of the questions before the Company Law Board in *Estate Investment Co. P. Ltd. v. Siltap Chemicals Ltd.,* (1999) 96 Com Cases 217 : (1999) 1 Comp LJ 314 : (1999) 32 CLA 409 (CLB—WB) was as to scope of the words "sufficient cause". The opinion of the CLB was that only those three grounds would constitute a sufficient cause on which the Company Law Board can order rectification of the Register of Member of company under s. 111A(3). Refusal by a public company on any other ground cannot be regarded as a sufficient cause for the refusal. The facts of the case were that the petitioner had advanced to a share broker sums of money as loans. As a security for the loans, share certificates of various companies were pledged by the broker. They were accompanied by share transfer forms duly signed by the owners of those shares. In the exercise of the right given to him, the petitioner, on default by the borrowing broker, lodged the transfer with the company for registration in his name. The company pointed out defects in the transfer forms. The company did not return the defective documents to the petitioner inspite of his request. In respect of some of the shares the petitioner lodged fresh transfer documents, the share certificates being already with the company. He again asked for return of the remaining shares and documents. The company informed him that the documents were being withheld because the transferors had filed a civil suit in the Bombay High Court in respect of the shares under transfer. It was pointed out in that suit that the owners had pledged their shares with the broker but had not authorised him to sell them. The CLB laid down the following principles :

1. The company should have returned the transfer documents to the lodger and not to have retained them on behalf of the transferors. To the objecting transferors the company should have told either to launch criminal proceeding to recover their property or to institute a civil case to restrain the company from registering the transfer.

2. The mere filing of a civil suit questioning the validity of the transfer was not a "sufficient cause" for refusing to register the transfer. An injunction restraining the transfer would be necessary; mere prayer is

not enough. The company was not bound to take cognizance of the suit in the absence of a stay order. Non-compliance with the requirements of s. 108 constituted a sufficient cause for refusal because any such transfer, if registered, would be in violation of law for the time being in force. In respect of shares for which fresh documents were filed and about which the company did not say that there was non-compliance with s. 108, there was no sufficient cause for refusal and the company could have been compelled to register the transfer of such shares.

3. The petitioner had not acquired the shares directly from the registered holders, but from a share broker by way of security for loans. Although the refusal by the company did not show a "sufficient cause", it would be necessary to know the nature of the transaction between the owners and the broker so as to ascertain whether the broker had any right to sell the shares and to confer a better title on the buyer than he himself had. The status of the share broker *vis-a-vis* the shares was relevant to be decided for the purposes of rectification. That question could not be answered in the absence of the broker. The petition suffered from non-joinder of parties.

Apart from the grounds mentioned in the section, a public company cannot refuse to accept a transfer of shares on any other grounds whatsoever. A public company was not allowed to refuse a transfer on the ground that the transferees were not natives of the company's State of registration. The word "native" was a part of the company's name. That was not taken to mean natives of the State. It could also mean natives of the whole country. *Namita Gupta v. Cachar Native Joint Stock Co. Ltd.,* (1999) 98 CLB 655 : (1999) 34 CLA 287 : (2000) 6 Comp LJ 511 (CLB—PB).

Where the transfer was complete in all respects and yet the company refused to accept it on grounds like, that share certificates were not there in full number, stamps were not cancelled etc., and the CLB found that matters raised by the company were all false, the company was ordered to accept the transfer. *Kamdhenu Chemicals P. Ltd. v. Advent Computer Services P. Ltd.,* (2000) 27 SCL 189 : (2000) 4 Comp LJ 424 (CLB—SB). Sub-section (3) is not applicable to public companies in all cases. The circumstances in which the sub-section is not applicable, the company is bound to register the transfer. *P.R. Gokhale v. Tamilnad Mercant Bank Ltd.,* (2001) 33 SCL 800 : (2001) 44 CLA 258 : (2001) 4 Comp LJ 419 (CLB—Chennai).

It was held to be not a sufficient cause for refusal that the shares under transfer were the part of a trust even if the trust is of perpetual nature. The CLB said that the shares being those of a public limited company, they were freely transferable. The company was not concerned with the terms of the trust. It had no authority to refuse to accept the transfer. *Jose Pulikken v. Damien Subsidies & Kuries Ltd.,* (2000) 39 CLA 180 (2000) 4 Comp LJ 421 : (2000) 28 SCL 183 : (2001) CLC 638 (CLB—SB).

Refusal to register short-term pledge.—Under RBI directions, bankers giving loans on pledge of shares are required to get the shares registered in their names. This has been held not to apply to a pledge created under a short-term loan. Accordingly, the refusal by the company to register a transfer under such short term pledge was held to be based upon a "sufficient cause". *Canara Bank v. Ankit Granites Ltd.,* (1999) 21 SCL 83 : (1999) 33 CLA 300 : (1999) 97 Com Cases 511 : (2000) 4 Comp LJ 391 (CLB—SB).

Where pledge not for short term.—Where the pledge created is not for a short term arrangement of credit, rather it is an arrangement for securing a cash credit account, the bank which has taken the relevant instrument of transfer would be entitled to register itself as a shareholder and would be entitled, in case of refusal, to invoke the proviso to s. 111(2) like any other transferee whose request for registration of transfer has been refused by the company. The fact that no consideration is mentioned in the transfer form does not destroy its validity particularly where the transfer is by way of security for a general balance of account in a credit arrangement. Furthermore, consideration has to be mentioned only for stamp purposes. The creditor was a nationalised bank in this case and such banks have been exempted from the requirement of stamp duty. *Indian Bank v. Kiran Overseas Exports Ltd.,* (2000) 4 Comp LJ 416 : (2000) 39 CLA 53 : (2000) 27 SCL 194 : (2001) 104 Com Cases 320 : (2001) CLC 1152 (CLB).

Pledge with blank transfer forms.—Where shares were pledged with a bank under blank transfer forms and the bank lodged the documents with the company for registra-

tion of the transfer, it was held that it was not a case of sale and, therefore, no notice to the pledgor was necessary and that the stop transfer instruction given by the pledgor was not a ground recognised by S. 111A for refusing registration. *Maruti Udyog Ltd. v. Pentamedia Graphics Ltd.*, (2002) 111 Com Cases 56 : (2002) 37 SCL 651 : (2001) 49 CLA 17 (CLB). Another similar decision is to be seen in *Deccan Cements Ltd. v. Geekay Exim (India) Ltd.*, (2002) 49 CLA 382 : (2002) 112 Com Cases 616 (CLB) : (2002) 38 SCL 277. It was held that the company could not refuse to register the transfer in the name of the pledgee when the pledge remained unredeemed.

Transfer in breach of contract.—The expression "sufficient cause" takes within its sweep not only those contingencies specified in sub-s. (3), but also other circumstances and reasons, e.g., A.P. High Court observed in *Karamsad Investments Ltd. v. Nile Ltd.*, (2002) 46 CLA 23 at pp. 40, 41, 42 : (2001) 34 SCL 269 : (2002) 108 Com Cases 58 (AP): "The scope of the power under sub-section (3) conferred on the CLB is limited only to the acquisition of shares in contravention of law, but violation of statutory law is not the only infirmity in the matter of acquisition of shares. In a given case, shares could be acquired or transferred by a person in contravention of some existing contractual obligations of the transferor or some other obligation attached to those shares.

The legal position in the case of such contravention of contractual obligations is discussed in PALMER'S COMPANY LAW, 24th Edn., at page 637 at para 40-34: "If the shares have been acquired by means of a loan which require payment of the debt out of specific property including those shares, such contract is enforceable by a grant of specific performance and creates an equitable interest in the shares in favour of the lender. A subsequent equitable mortgagee of the shares, who proposes to deal with the shares in such a way as to cause a breach of that contract will be restrained by injunction if he acquired them with actual knowledge of the contract." "This position of law stated by PALMER is based on a decision of the Court of Appeal reported in *Swiss Bank Corpn. v. Lloyd Bank Ltd.*, (1982) 2 All ER 419. "The principle of law was **affirmed** by the House of Lords on an appeal from the above decision [(1981) 2 All ER 449], though on the facts of the case both the courts held that there was no violation of any contractual obligation. It, therefore, follows that a party seeking to transfer shares held by him which would result in the breach of an obligation attached to the shares created by a prior contract could be injuncted from transferring the shares. It logically follows that the transfer if made and registered even before the aggrieved party could obtain an order of injunction, the transfer could be declared illegal in an appropriate action before a court of law, in which case the company would be bound by such a declaration made by the court, of the illegality arising out of a breach of the contractual obligation and bound to give effect to the decree of the court to refuse registration of transfer.

The declaration of free transferability contained in section 111A(2), must be understood in the background of the pre-existing legal position that the articles of association of a company could restrict the right of the shareholder to transfer his shares. The existence of such power is still recognised in the context of private companies under section 111. But the right to transfer is the right of the holder of the shares (property). All that section 111A(2) declares is that such a right cannot be restricted. However, a transfer of property requires always two parties; the transferor and transferee. The declaration of the right of the transferor need not always create a corresponding legal right in the transferee. For instance, to take an extreme example, a transferor decides to transfer his shares in favour of a person who is legally incapacitated to enter into a contract; like an alien enemy, or an insane person the transaction is clearly illegal in which case the transferor cannot be heard to say that his right to freely transfer the shares held by him is curtailed. In such cases what is curtailed is the right of the acquirer. From the examination of the scheme of sections 108A to 108G it is clear that the Parliament thought it fit to curtail the right of the acquirers in certain cases, either in the interests of the company or the public [*see* 108B(2), 108D, Companies Act]. Though it is not made express in section 108A, the Central Government while exercising the authority under the said section is obviously required to keep in mind both the above mentioned factors, *i.e.*, interests of the company and public. The language and the scheme of section 108D makes the above clear.

Therefore, if the interest of the company is one of the factors to be considered by the Central Government while granting or declining to grant the approval under section 108A or 108D, necessarily the government is required to examine various factors like the impact of the acquisition on the management of the company, whether such an impact is desirable, etc. The existing legal obligation of the company should also be one of the factors. If that is the true import of the scheme of sections 108A to 108G, the company (target) would be equally entitled to at least make an assessment of the probable impact of the registration of the acquisition of the bulk shares by any acquirer on the interests of the company. If in the process the company comes to the conclusion that registering such a transfer would be detrimental to the interests of the company, the company could certainly avail the benefit of section 108D and seek appro-

priate directions from the Central Government or in the alternative itself take a decision to refuse registration and render itself liable for an appellate scrutiny by the CLB as provided under section 111A(2), *proviso.*

Similarly, if the transfer of shares in favour of a person is likely to create, or, would ultimately place the company itself, in a situation to make a breach of certain existing contractual obligations of the company, thereby exposing the company to action in law, the company would be justified in refusing to register such transfer of shares.

The expression 'sufficient cause' occurring in the *proviso* to sub-section (2) of section 111A takes within its sweep not only those contingencies contemplated under sub-section (3) but there can also be circumstances and reasons other than those contemplated under sub-section (3) which might require the company to refuse to register the transfer of shares and such a refusal would be refusal for 'sufficient cause'.

Thus, there can be various reasons, though it is not possible to enumerate all of them and it is to be decided on the facts of each case, which could constitute 'sufficient cause' for a company to refuse the registration of transfer of shares."

Loss of share certificate.—Where the company found no difference in the signature on the transfer forms and specimen signature lying with the company and accordingly registered the transfer, it was held that a stop notice received from the transferor thereafter was too late. The registration was neither illegal nor improper. The transferor alleged that he had lost share certificates; but he neither filed a police report, nor made the transferee a party to the proceeding. It was held that an order for rectification of the register of members could not be passed. *Bhuwaneshwar Nath Nigam v. Hindustan Lever Ltd.*, (2002) 111 Com Cases 590 (CLB).

Loss of documents in transit.—In *Jitendra J. Bhabhera v. Forbes Gokak Ltd.*, (2002) 38 SCL 304 : 2002 CLC 1571 (CLB—Mum.) the petitioner had sent share certificates alongwith duly executed transfer deed to the company for transfer in his name. The consignment was lost in transit. The petitioner filed a civil suit in which he obtained the decision that he was the owner of the shares and, therefore, the company was restrained from registering those shares in the name of any one else except with the petitioner's consent. But even before this restraint order the company had transferred the shares to another person (the respondent). The company was directed by the CLB to rectify the register of members recording the petitioner's name in place of the respondent and to pay all consequential benefits including dividends.

Refusal by Stock Exchange Company to accept transfer.—Where a stock exchange refused to accept a transfer of shares on the ground that the transferee was called upon to deposit the consideration money but he had not done so, it was held that such a ground was not permissible. The decision of refusal was made two years after lodgement of documents. The Company Law Board also said that the stock exchange has no right of lien. A purchaser is not expected to find out whether the right of lien exists. *Shyama Prasad Murarka v. Calcutta Stock Exchange Assn. Ltd.*, (2002) 108 Com Cases 703 : (2002) 46 CLA 13 (CLB—ER).

Failure to exercise option for allotment of shares.—A listed company issued tradable warrants with an option to get allotment of shares after making full payment. The option was to become extinguished if not exercised within the delimited time. The company allotted shares to those who opted for it on payment of consideration. It was held that those who did not exercise the option within time were not entitled to get the allotment and seek rectification of the register of members for that purpose. The allotment of unopted shares to persons of the company's choice was neither arbitrary nor discriminatory. *Sanmukhlal Rangildas Ghael v. Reliance Petroleum Ltd.*, (2001) 3 Comp LJ 273 : (2001) 43 CLA 75 : (2001) 32 SCL 301 (CLB—WR—Mumbai).

Cases in which relief allowed

Signature not tallying.—A company refused to register a transfer on the ground that the signature of the transferor did not tally with the specimen signatures. The transferee sent a letter to the transferor for fresh execution of documents. The letter came back as

undelivered. The transferee filed a petition under the section making the transferor a party but even then she did not put in appearance. It was held that since the transferor had not filed any reply, the original certificates were with the trnasferee petitioner, petitioner's letter to the transferor came back unserved, and she had not till the date of the order sought duplicate certificates and there was no other claimant for the shares in question, it would be appropriate that shares be registered in the name of the transferee. *Abhipara Capital Ltd. v. JCT Electronics Ltd.*, (2002) 111 Com Cases 863 : (2002) 37 SCL 830 : (2002) CLC 945 (CLB).

In *A Nitin Capital Services Ltd. v. Larsen & Tourbo Ltd.*, (2002) 40 SCL 327 (CLB—Mum.), the petitioner had sent duly executed and stamped instrument of transfer for 1640 shares in the company alongwith the original share certificates. The documents were returned on the ground that the transferor's signature was not tallying. The petitioner resubmitted the set but was lost in transit. Objections in respect of some of the shares were received. The company was directed to transfer the remaining shares in the petitioner's name with all the consequential benefits. For the rest the petitioner was free to take any action that he might be advised.

Negligence of company in issuing duplicate share certificates.—The petitioner purchased 100 shares in the company from the respondent through a broker and lodged the documents for registration of the transfer with the company's share transfer agent. The share transfer agent subsequently wrote a letter to the transferor that her request for stop transfer could not be considered as her signature tallied with the records of the company. When the petitioner contacted the share transfer agent she was informed that it had ceased to be the share transfer agent of the company. The company informed her that it had already issued a duplicate share certificate in respect of the shares in question to the transferor and had also issued 100 bonus shares to her. On a petition under section 111A for rectification of the register and under section 113 for delivery of share certificates, it was held, that in view of the stand of the transfer agent that the signature of the transferor on the transfer instrument tallied with the records of the company, it was clear that the share transfer agent had received the documents. If the duplicate certificate had been issued before that date there was no need for the share transfer agent to have issued the letter of that date. No duplicate certificate could have been issued after that date since the share transfer agent was in possession of the original. Thus, the share transfer agent and the company had been negligent in issuing duplicate shares and not acceding to the petitioner's request to register the 100 shares in her name. The petitioner was entitled to have her name entered as the owner of the 100 shares in the register of members of the company. The company was to delete the name of the transferor from its register and also to enter the petitioner's name as the owner of the 100 bonus shares issued. The company was also to pay the petitioner dividends on the shares declared after date of purchase and compensation of Rs. 5000 for its negligence. *S. Seetha v. Satyam Computer Services Ltd.*, (2002) 112 Com Cases 139 : (2002) 38 SCL 190 : (2002) 4 Comp LJ 485 (CLB).

CLB power where High Court passed no order, substitution of deceased trustee.—The CLB ordered the transfer of shares held by a trust to the names of existing trustees from that of a deceased trustee though 20 years ago the High Court declined to pass any order on merits under s. 155 and gave the trustees the right to file a civil suit. The CLB took action on the contention of the company subject to the condition that the trustees would withdraw the suit filed by them within 30 days of the CLB order. *Balram Jaidayal v. Charity Trust v. CESC Ltd.*, (2003) 57 CLA 431 (CLB).

Cases in which relief not allowed

Time-bar and nullity of forged transfer.—Share certificates were stolen from company's share department. The purchase seemed to have been made on forged transfer documents. The shares were accordingly restored to the rightful owner's name. The purchaser had no title and, therefore, could not seek rectification. The petition was also bad in law for non-joinder of necessary parties. It was also filed two years after the name of

the original owner was restored to the register. Thus it was time-barred and, therefore, not maintainable. *Gurnam Singh Gujral (Col) v. Indian Hotels Co. Ltd.*, (2002) 112 Com Cases 86 : (2002) 40 SCL 321 (CLB). The Western Bench of the CLB was emboldened by the following ruling. In *Kaushalya Devi v. National Insulated Cable Co. (I.) Ltd.*, (1997) Tax LR 1928 (Delhi), it was held that "where shares were transferred by means of forged trnasfer deed, the transferee did not get any rights in respect of the shares. The fact that he was a *bona fide* purchaser for value would not make any difference, forgery is nullity. The person receiving shares under a forged instrument of transfer gets no right. He is bound to return the scrip(s) to the person they rightfully belong". In this case a stranger managed to get hold of shares of a shareholder of the company and forged the shareholder's signature on the transfer deeds and had the shares transferred in a third person's name, the shareholder who had not signed the transfer deed was accordingly prejudiced/affected by the transfer. The court held that the company could be held liable *qua* the original shareholder and also held that the transfer even in the hands of *bona fide* purchaser for value without notice could not pass title to the purchaser of the shares.

Shares returned because of bad delivery.—Certain shares were lodged by the petitioner with the company for registration. They wrer returned because of bad delivery after the limitation period was over. The CLB held that the company could not be compelled to register the transfer. In respect of some other shares also no order was passed against the company because the latter denied having received original certificates and the petitioner had no proof of sending them. *Zurich India Mutual Fund v. Satyam Computer Services Ltd.*, (2002) 38 SCL 215 (CLB).

Removal of name under forged documents.—In a petition under section 111A, the petitioner sought rectification of the register of members of the company, alleging that his signature had been forged on transfer documents. The company disputed this. The petitioner had also filed a criminal case against the company alleging forgery. It was held that to determine the right of the petitioner to get into the register of members, the Board had to give a finding whether the signature was a forged one as claimed by the petitioner. A categorical finding one way or the other could not be given on the basis of the original document. In summary proceedings under section 111A it was not possible for the CLB to make a roving enquiry into the matter. Since the criminal court was already seized of the matter, taking into consideration the undertaking given by the company that if the criminal court found that the singature was forged, it would restore the name of the petitioner in respect of the shares in question, the matter of determination of the genuineness of the signature was to be left to the criminal court. *S. Sivakumar v. Cirlacs Data Systems Ltd.*, (2002) 112 Com Cases 162 : (2002) 37 SCL 789 : (2002) 49 CLA 67 : (2002) 4 Comp LJ 493 (CLB).

Uncancelled stamps.—The fact of uncancelled stamps has been recognised only as an irregularity and not an illegality. The CLB accordingly held that the registration of the transfer could not be refused on that ground. *Kosha Chandravadan Parikh v. Krishna Mingranite Ltd.*, (2002) 51 CLA 142 : (2002) 40 SCL 679 (CLB). Reliance was placed upon the decision in *Kothari Industrial Corpn. v. Lazor Detergent P. Ltd.*, (1994) 15 CLA 142 : (1994) 81 Com Cases 699 (Mad), where it was noted that the state suffers no loss of revenue in such a case. The requirement of cancellation was, therefore, directory and not mandatory.

§ See also Notes under section 108 under the heading "Stamp duty on transfer of shares".

Shares deposited as security.—In *Mani Credit Capital P. Ltd. v. Reliance Industries Ltd.*, (2002) 111 Com Cases 808 : (2002) 38 SCL 762, shares were given as a security for a loan with an option on the part of the borrower company to pay back the loan and to have the shares retransferred to it. The borrower company went into liquidation. A scheme of certification was drawn up for shares lodged for transfer. It was held that certi-

fication was not needed for shares lodged for transfer prior to the cut of date. The CLB directed the company to register the transfer and to pay all the benefits which had accrued in the mean time in respect of those shares.

Refusal to accept splitting up of joint holding.—The refusal by a company to accept splitting up of joint holding was held to be justified where neither the consent of other joint shareholders was filed, nor the original certificates, nor the sale deeds duly signed and stamped, as required under the Act, were furnished. The CLB said that the refusal was neither illegal nor without sufficient cause. *Rajiv Das (Dr.) v. United Press Ltd.*, (2002) 1 Comp LJ 170 : (2002) 45 CLA 387 : (2002) 111 Com Cases 584 (CLB—ER—Kolkata).

Disputed ownership of shares

The company did not accept transfer of shares in favour of the petitioner on the ground that the ownership of the shares was in dispute. The civil court gave a finding that the petitioner had purchased the shares for which application for registration had been lodged with the company and vacated the injunction order. Though an appeal against this decision was pending, there was no stay order against registration in favour of the petitioner. The CLB ordered that the company would register the transfer subject to the outcome of the High Court decision in the pending appeal. *Ashok Kumar Puri v. Vision Technology Ltd.*, (2002) 38 SCL 207 (CLB—Chennai). The petitioner had purchased shares of the company from two members but the company refused to accept the transfer because various proceedings between the parties were pending. A division of the company was purchased by another company and that other company also refused to take the impugned shares. The company and the parties entered into a compromise before the civil court under which the other company agreed to purchase those shares. It was held that by reason of the compromise the company was bound to register the shares in the name of the petitioner and respondents and thereafter the other company would be bound to purchase all the shares from the hands of the petitioner and respondents. *Sourath H. Bora v. Raasi Cement Ltd.*, (2002) 38 SCL 213 (CLB). In *Rajesh Ahuja v. Reliance Industries Ltd.*, (2002) 40 SCL 356 (CLB—Mum.), the plaintiff purchased certain shares of the company and lodged duly executed transfer form and the original share certificate for transfer registration. The company informed him that it did not receive the share certificate and the shares inscribed in it had already been transferred to others on forged deeds. The petitioner obtained a court decree declaring him to be the owner of the shares. Those others did not appear in the suit nor made any objection in the matter. The company was directed to cancel the spurious registration and register the petitioner in respect of the shares and pay him all the consequential benefits like dividends, bonus, etc.

Where the company did not issue bonus shares because of a dispute as to ownership between the registered holder and the person claiming to be the purchaser, the civil suit having been decided in favour of the original holder, the company was directed to issue bonus shares in his favour. *Susheela Ostwal v. Satyam Computer Services Ltd.*, (2002) 2 Comp LJ 516 (CLB).

Transfer in violation of SEBI Guidelines [DIP Guidelines 1992]* [Sub-section (3)]

The Company Law Board in its decision in *SPS International Ltd. v. Vijay Remedies Ltd.*, (1998) 93 Com Cases 547 : (1998) 30 CLA 113 : (1998) 3 Comp LJ 524 (CLB—N.B.) explained the scope of the power of the Company Law Board in the matter of rectification of the Register of Members of a public company. The Board said : [at p. 551] "It is clear that the Company Law Board may on an application made by an investor order rectification in case the transfer of shares is in contravention of certain laws mentioned therein. In other words, an investor can apply to the Company Law Board in case a transfer has been already effected in contravention of any laws mentioned in sub-

* Since replaced by SEBI (Disclosure and Investor Protection) Guidelines, 2000. For text see *Appendix* 162.

fer has been already effected in contravention of any laws mentioned in sub-section (3). In other words, so long as there is no contravention of any of the laws mentioned therein, an application cannot lie..... Thus, any allegations of fraud, forgery, lack of authority, procedure adopted with regard to transfer *etc.*, are grounds which are not available any more for a rectification petition." The question in this case is that of violation of SEBI Regulations. On June 19, 1992, SEBI issued Guidelines under the heading "Promoters' contribution and lock-in-period", which provided that the promoters' quota shall not be diluted for a lock-in period of five years from the date of commencement of production or date of allotment whichever is later. Subsequently by a Press Release on Oct. 10, 1994 a clarification was issued to the effect that "transfer of shares amongst promoters specifically described as such in the prospectus is also permissible but the requirement relating to lock-in period would continue to apply to the extent initially prescribed." It is patently clear that a conscious distinction has been made between "promoters" and "promoters group". It is clear that the relaxation does not apply to the constitutents of the promoters group, *i.e.*, promoter's relatives, friends, associates, *etc.* The relaxation covers transfers amongst promoters specifically described as such in the prospectus." In this case, four promoters were named in the prospectus to whom the restriction was not to apply. The petitioners, as original allottees in the promoters' quota, were not among them. Transfers of their shares to other allottees in the promoters' group were not exempt. They were in violation of SEBI Guidelines. The prayer of the petitioners for rectification of the register of members could not be allowed.

Violation of SEBI Takeover Regulations.—Where the acquisition of shares exceeded 10% and the procedure as to public announcement of such acquisition as prescribed by the Takeover Regulations [SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997] was not followed, that was held to be a "sufficient cause" within the meaning of s. 111-A for the company not to register the transfer. It was further held that in taking the count of 10%, [*now 15%*] share transfers which had not been lodged with the company because they were still under the lock-in-period would have to be taken into account because the acquirer had taken in respect of those shares irrevocable power of attorney and, therefore, became entitled to exercise voting rights. *Bakhtawar Construction Co. P. Ltd. v. Blossom Industries Ltd.*, (2000) 99 Com Cases 44 : (2000) 36 CLA 14 (CLB—WB).

Of the three grounds mentioned in s. 111A which empower the CLB to order rectification, one was involved before the CLB in *Azzilfi Finlease and Investment P. Ltd. v. Ambalal Sarabhai Enterprises Ltd.*, (2000) 1 Comp LJ 118 : (1999) 35 CLA 437 (CLB—WB). The refusal by the company to register a transfer of shares in this case was on the ground of violation of SEBI Takeover Code. The company placed before the CLB inadequate material in support of the allegation and, therefore, a sufficient cause for refusal was not made out. Further, SEBI itself was in seisin of the matter of violation and it has power under Regulation 44 of the Takeover Regulations for giving directions for setting the matters right. In the meantime why the investors should suffer. The company was directed to register the transfers. Another similar case is *Redwood Holdings P. Ltd. v. Sandesh Ltd.*, (2003) 41 SCL 246 (CLB—Mum.). Here also the allegation of acquisition beyond 5% was not proved. The company's refusal being not sustainable, it was directed to register the transfer. It was further held that the appropriate forum for taking case of violations of SEBI Regulations is SEBI itself and not the CLB. If some further inquiry or investigation is necessary, that would also have to be handled through SEBI authorities.

Two companies (holding and subsidiary) acting in concert, acquired substantial shareholding in another company. The other company refused to register the transfer. A petition was filed for a direction to the company to register the transfers of shares which were acquired before and after the public offer made by the company. It was held that in terms of regulation 7 of the SEBI Regulations, GMM (acquiring company) should have informed the company within four days of such acquisition. Such an intimation was given only after a delay of more than a month. Therefore, there was a clear contravention of the provisions of regulation 7 of the Regulations. The public held 9.91 per cent. of the shares at the time when K (another acquiring company) made the public offer to acquire 20 per

cent. of the shares in the company. Since the proposal to acquire 20 per cent. of the shares together with the existing shares amounted to more than 25 per cent of the shares, the petitioner should have obtained the previous approval of the Central Government before making the offer. Since the petitioner had not done so, the acquisition of the shares during the period was in violation of the provisions of the Companies Act. Therefore, the refusal by the company to register the transfers was with "sufficient cause". The petitioners, being the holding and subsidiary companies, respectively, were acting in concert to acquire the shares of the respondent company and, therefore, the case fell within the meaning of the provisions of regulation 2(*e*) of the SEBI Regulations. Further, the holding of both the petitioners in the aggregate amounted to 5.287 per cent. of the shares, thus exceeding the threshold limit of five per cent. stipulated in regulation 7 of the SEBI Regulations.

"Explaining the impact of the insertion of s. 111A, the CLB said : Even before the provisions of section 111A were inserted in the Companies Act, the power of the Board of directors of a listed company to refuse registration of transfers was restricted by the provisions of section 22A of the Securities Contracts (Regulation) Act, 1956, only on certain grounds, notwithstanding the provisions of section 111 of the Act. The Legislature has consciously differentiated the grounds for refusal for listed and unlisted companies. (including private limited companies) even before insertion of section 111A. Section 111A was introduced simultaneously with repeal of the provisions of section 22A of the Securities Contract (Regulation) Act, 1956, and most of the grounds provided therein have been provided in section 111A(3), except the one relating to change in the composition of the Board of directors. While section 111A stipulates that the shares of public companies are freely transferable, section 3(1)(*iii*) authorizes a private company to make provisions in the articles to restrict the right to transfer shares. Thus, the shares in a public company are not similar to the shares in a private company. While all the grounds specified in that section are applicable to a listed company, an unlisted public company can refuse registration of transfer of shares if the same is in violation of the provisions of any Act or the SICA. Therefore, it was held that the term "sufficient cause" as appearing in the proviso to section 111A(2) would cover only the instances under which rectification of the register of members can be ordered, in terms of section 111A(3). If the company's refusal to register the transfers falls within any of the grounds specified in section 111A(3) then registration could not be ordered." *Gujarat Machinery Mfrs. Ltd. v. Nile Ltd.*, (2001) 105 Com Cases 817 at 825 : (2001) 40 CLA 1 : 2001 CLC 649 : (2000) 5 Comp LJ 340 (CLB—SR)

Companies concerned in the process of acquisition by individuals would also be regarded as acquirers and acting in concert with individuals. The words "who holds shares" in Regulations 9 and 10 of the SEBI Takeover Regulations would have to be taken to include, to give them some purposeful meanings namely, a person whose holding in the company may be nil or who holds shares with a right to get his name registered as a member, but not yet entered in the register. The object of the regulations is to bring about transparency in dealings in securities and also to enable existing shareholders to take informed decisions in accepting or refusing to accept a public offer made by the acquirer. *Shirish Finance & Investment P. Ltd. v. M. Shreenivasulu Reddy*, (2002) 109 Com Cases 913 : (2002) 2 Comp LJ 386 : (2002) 47 CLA 82 (DB—Bom).

Contravention of any other law

The expression "or any other law for the time being in force" in s. 111A(3) has to be read in the context of the other words used in sub-section and would be confined to statute law. A public company in this case was refusing to register the transfer of shares to a business rival. This was held to be not a permissible ground of refusal under the section. *McDowell & Co. Ltd. v. Shaw Wallace Ltd.*, (2002) 108 Com Cases 306 : (2001) 45 CLA 380 : (2002) 1 Comp LJ 160 (CLB—PB).

Refusal to accept transmission

The refusal by the directors to accept a transmission of shares has been held to be appealable under s. 111A(2). The legal heir of a deceased shareholder produced all the papers which showed that he was legally entitled to succeed to the shares in question. The CLB said that the company should not make a roving inquiry. The company is bound to register transmissions. There was evidence to show that the matter was not even placed before the company's board of directors. Refusal was not a *bona fide* one. The company was directed to register the transmission. It was also held that time-limit prescribed by the Companies Act would be applicable, but not the Limitation Act before CLB. *Anil R. Chhabria v. Finolex Industries Ltd. and Finolex Cables Ltd.,* (2000) 99 Com Cases 168 : (1999) 22 SCL 437 (CLB–WB). The CLB observation that the words 'or intimation of transfer' as they occur in sub-section (2) proviso should have been 'or intimation of transmission' and that this was a drafting error, has been **disapproved** by the Bombay High Court in *Finolex Industries Ltd. v. Anil Ramchand Chhabria,* (2000) 37 CLA 278 : (2000) 3 Comp LJ 330 (Bom) : (2000) 3 Bom CR 644. The decision on merits remained the same. The court said that remedies under sub-ss. (2) and (3) are available for transfer as well as transmission matters. In view of this ruling, the decision of the CLB in *Sashi Prakash Khemka v. NEPC Mikons Ltd.,* (1997) 26 CLA 316 also became **disapproved.** The CLB had adopted the view in this case that s. 111A was confined in its application to transfer matters only and was not applicable to non-transfer matters like transmission and that in non-transfer matters the remedy could be had only from a civil court. This decision became **disapproved** because of the Bombay High Court ruling that the section would cover transmissions also. *Finolex Industries Ltd. v. Anil Ramchand Chhabria,* (2000) 37 CLA 278 (Bom). The court proceeded as follows :

The court noted that the provisions of the Depositories Act are in addition to and not in derogation of any other law for the time being in force relating to the holding and transfer of securities. The position before the amendment was that sections 108 and 111 dealt with transfer of shares and the remedies of appeal and rectification in case of refusal or dealy in registration of a transfer. Section 111 applied to both private as well as public companies. However, by the Depositories Act, sub-section (14) was added to section 111 of the Companies Act which is as under:

"(14) In this section 'company' means a private company and includes a private company which had become a public company by virtue of section 43A of this Act."

This sub-section limited the operation of section 111 to private companies only. By enactment of this sub-section the remedy of appeal and rectification provided to the shares held in public companies under section 111(2) and 111(4) has been omitted. Therefore, provision for the continuance of the remedies under sections 111(2) and (4) had to be made in the Depositories Act.

These remedies were sought to be provided by adding section 111A. But mistakes seem to have crept in at every stage of drafting the necessary provisions. This can be seen by examining the original provisions of section 111A and the efforts made by the Legislature to correct the mistakes. The court noted here the original provisions of S. 111A which were minus the proviso to sub-s. (2). Noting the lacuna, the court said that a perusal of section 111A(1) together with section 111(14) made it clear that section 111 became limited in its operation to private limited companies. But at the same time a perusal of section 111A(2) showed that no remedy of appeal had been provided to any kind of shares held in public companies. A perusal of section 111A(3) would show that no remedy of rectification was available if the register remained inaccurate by contravening the provisions of the Companies Act. The remedy was only provided for rectification if there was a contravention of any of the provisions of the Securities and Exchange Board of India Act, 1992 or Regulations made thereunder or the Sick Industrial Companies (Special Provisions) Act, 1985. Section 111(2) completely failed to provide a remedy of appeal. Section 111A(3) provided only a partial remedy of rectification. Thus, these provisions instead of providing additional benefits, had actually taken away, either completely or partly, the rights and remedies already available. Clearly, therefore, sections 111A(2) and (3) were not in addition to the laws for the time being in force but were in derogation thereof. This was not the intention of the Parliament as expressed in section 28 –of the Depositories Act. In order to rectify the two provisions mentioned above, the Depositories Act was amended by Depositories Related Laws (Amendment) Act, 1997. By this amendment a proviso was added to section 111A(2) and section 111A(3) was substituted. The court cited here the substituted provisions and continued :

Unfortunately even this effort of the Legislature leaves much to be desired. Even the new provisions do not expressly provide that remedies under sections 111(2) and (4) are continued. From a perusal of the proviso it becomes apparent that a provision of appeal is provided in case a company refuses to transfer the shares within two months of the receipt of the 'instrument of transfer' or the 'intimation of transfer'

On a literal interpretation this would mean that no remedy of appeal is available in case of non-transmission of shares on the delivery of intimation of transmission. It is this interpretation which led the CLB to substitute the term 'instrument of transfer' with 'instrument of transmission'. The approach adopted by the CLB is not correct. A careful and meaningful analysis of these provisions would clearly demonstrate the intention of the Legislature to give equal treatment to shares held in public companies. This intention can be discerned from the process of amendments. There can be no disparity in the treatment of shares based on the mode of transfer or transmission. Therefore, the necessary provision was sought to be made in the proviso to section 111A(2) and section 111A(3). Unfortunately it seems due to the haste in which the Depositories Act, 1996 and the Amendment in 1997 were enacted the intention of the Legislature was not reflected in the provisions. In the absence of the provision for 'intimation of transmission' in the proviso it would appear that there is no appeal provided. But this would be in conflict with section 28 of the Depositories Act which makes it clear that the provisions of the Act shall be in addition to and not in derogation of any other law for the time being in force relating to holding and transfer of securities. Thus, the proviso has to be construed in such a manner that would preserve the rights and remedies already available to the shareholding, in public companies. The interpretation would have to be such that section 111A provides additional benefit to the shareholders in public companies which they already enjoyed and continue to enjoy under section 111. Only then the proviso would be able to give effect to the intention of the Legislature. The interpretation cannot be such as to deny the right of appeal to shareholders of a public company on the basis of the mode of transfer or transmission. At the same time it should not leave the shares held in depositories without a remedy of appeal. Substitution of the term 'intimation of transfer' with 'intimation of transmission' would remove the right of appeal given to shares held by depositories. This is not the intention of the Parliament.

The court said the CLB unnecessarily fell into confusion over the term 'intimation of transfer'. All shares held in depositories are to be dematerialised and fungible. Transfers are to be effected electronically. Remedy of appeal is provided if the transfer is not registered by the company (issuer) or depository within two months of the receipt of 'intimation of transfer'. It is in this sense that the term 'intimation of transfer' has been used in the proviso.

Talking further of the CLB error, the court said that another justification given by the CLB for the 'drafting error' conclusion is that without such a construction, the term, 'intimation of transfer' does not carry any meaning as, if one approaches the CLB with a complaint that the company has refused to register the transfer on delivery of intimation of transfer, CLB cannot direct the company to register the same as it would be contradictory to the mandatory provisions of section 108. This conclusion is not warranted from section 108 of the Companies Act read with the Depositories Act. Under the Depositories Act the transfers of shares are to be effected under the provisions of the Depositories Act. Detailed provisions are made about the ownership and transfer of shares by electronic means. Further elaborate provisions are made under the SEBI (Depositories and Participants) Regulations, 1996. To make this absolutely clear the Legislature has amended section 108 and inserted sub-section (3) to section 108. This sub-section is as follows:

> "(3) Nothing contained in this section shall apply to transfer of security effected by the transferor and the transferee both of whom are entered as beneficial owners in the records of a depository."

A perusal of this sub-section makes it abundantly clear that section 108 is not applicable to transfers where the transferee and the transferor are entered as beneficial owners in the records of a depository. Thus, for this reason it could not have been held that the 'intimation of transfer' carries no meaning. It may be made clear here that the shares which are not held by depository can only be transferred under section 108. For these transfers an instrument of transfer is required by the company. Ideally, since the proviso mentions both 'instrument of transfer' and 'intimation of transfer', the term 'intimation of transmission' ought also to have been mentioned. This would have made the meaning explicit. Absence of the term from the proviso, however, cannot be construed to mean that no remedy of appeal is provided in case of non-registration of transmission of shares. This construction of the proviso is to be avoided, as it would rob section 111A(7) of the Companies Act and section 28 of the Depositories Act of any meaning and content. It would not give effect to the intention of the Legislature to make law in addition to and not in derogation of any law for the time being in force. Better course would be to interpret the provisions in such a way that the term 'intimation of transmission' is included in the proviso by virtue of section 28 read with section 111A(7). This would harmonise the text of the proviso with the context of the whole statute, *i.e.*, Depositories Act. Viewed in this manner, it is to be seen that both the terms 'instrument of transfer' and 'intimation of transmission' are mentioned in section 111(1) and section 111(2). By virtue of section 117A(7), whilst exercising the powers under section 111A, the CLB is to decide the appeal by applying the provisions of sections 111(5), (7), (9), (10) and (12). Thus, the term 'intimation of transmission' is deemed to be included in the proviso to section 111A(2) by necessary implication. This is the only harmonious construction which can be put on the proviso to section 111A(2) to give effect to the intention of the Legislature. The absence of the term 'intimation of transmission', in proviso to section 111A(2) cannot be construed to mean that no remedy of appeals is available to shares which are trans-

mitted by operation of law. Therefore, it is not necessary to substitute the term 'intimation of transfer' with the term 'intimation of transmission'.

Noting another effect of the amendment, the court said :

"The original section 111A(3) was substituted by the present provisions. The term 'any law for the time being in force' was inserted. This has now made it clear that the remedy of rectification is available to all shares whether held in depositories or in the form of share certificates. The fact that this was always the intention of the Parliament is apparent from the fact that even the provision, as it was originally drafted, had made a provision for rectification of register in relation to 'instrument of transfer' and 'intimation of transmission', it was necessary to mention 'instrument of transfer' and 'intimation of transmission' as the shareholder has an option either to remain within the depository or to change the mode of securities to share certificates. At that stage it would be necessary to deliver either the instrument of transfer or the intimation of transmission. By virtue of provisions of section 28 of the Depositories Act it cannot be held that section 111A(3) is restricted to rectification of the register only in transfer matters. This would mean that no remedy of rectification is available in case of loss of shares, bad deliveries, theft and forgery. This would be in derogation of the law for the time being in force. Remedy provided in section 111A(3) is in addition to the remedy provided in section 111(4). It is therefore, held that the remedies of appeal and rectification are available to all kinds of shares held in a public company under the proviso to section 111A(2) and section 111A(3) read with sub-section (7) of section 111A which would make applicable the provisions of section 111(1), (2) and (4) by virtue of section 111(5)."

Refusal to accept transmission by small company.—A refusal to accept a transmission was held to be justified in *Xavier Joseph v. Indo Scottish Brand P. Ltd.,* (2002) 38 SCL 195 (CLB—Chennai). The petitioner who was the son of a shareholder had in the past entered into the factory premises of the company and vandalised property. The Board of directors took a decsion that no new member, not even the close relatives of the existing members, would be admitted into membership. The articles of association of the company and its regulations gave discretion to the Board in the matter of transfer and transmission of shares. On the death of the petitioner's father, the company refused to take him as a shareholder but offered to pay him the value of his shares. It was held that the company did have the power to refuse a transmission, where it feels *bona fide* it is in the interest of the company that the legal heir, if admitted, would disrupt harmony among members, the company being an entity with a very small number of shareholders.

Prescribed procedure to be followed.—For effecting a transmission of shares the prescribed procedure has to be followed. In the case of an alleged *benami* holding, the shares in question were transferred to the name of the person for whom the deceased *benamidar* was supposed to be holding them. This was found to be wrong and the shares were restored to the original member's name. From here they could not be automatically transmitted to the name of the legal heir. It would have to be done in accordance with the procedure prescribed by law. The fact of *benami* holding was not declared in accordance with the requirement of s. 187C. *Anand Hemant Patel v. Ornate Club P. Ltd.,* (2000) 99 Com Cases 6 : (2000) 36 CLA 6 (CLB—WB). [Note : S. 187C has been *omitted* under the Amendment Act, 2000].

Scope of CLB Powers

The Company Law Board has held that any petition filed after the enforcement of the above amendment would be affected by it even if the cause of action arose earlier to the effective date of the amendment. Accordingly CLB refused to provide any relief under a cause of action which arose in 1994 but for which a petition was filed after the effective date. The CLB said that the jurisdiction is applicable as on the date of the filing and not as on the date of cause of action. *Shashi Prakash Khemka v. NEPC Micon Ltd.,* (1997) 90 Com Cases 228: (1997) 4 Comp LJ 265 (CLB—SB). The Bombay High Court in *Finolex Industries Ltd.* case *(Supra)* **overruled** the CLB's order, laying down *inter alia,* that remedies under the proviso to section 111A(2) and under section 111A(3) are available to transfer as well as transmission matters.

No jurisdiction to order duplicate shares.—There is no jurisdiction under the section for ordering the issue of duplicate share certificates. The CLB has jurisdiction to adjudicate only where there is refusal to accept a transfer of shares or to pass an order where rectification of the share register has become necessary. Provisions for issue of duplicate share certificates have been made in Rule 4(3) of the Companies (Issue of Shares Certifi-

cates), Rules, 1960. *Pushpaben Kalyanbhai Vasa v. Grasim Industries Ltd.*, (2002) 50 CLA 397 : 2002 CLC 1574 (CLB). The following ruling in *Andhra Pradesh Paper Mills Ltd. v. Pompasar Distillery Ltd.*, (1997) 26 CLA 316 (LBB) was **relied** upon :

"Any right to move the CLB in respect of a public company could only be under the provisions of the section 111A. As far as transfer matters are concerned, now provision exist under the proviso to sub-section 111A(2) as well as 111A(3). However, rectificatioin in respect of non-transfer matters cannot be sought before the CLB as no jurisdiction in these matters has been conferred on the CLB under that section. Therefore, under the existing provisions, the only remedy available is that, one has to move the civil court."

It was also stated that : "one has to move a forum which has the jurisdiction to entertain the matter on the day of filing a petition, and not a forum which had the jurisdiction when the cause of action arose but does not have the jurisdiction when a petition is filed."

No jurisdiction for investigation.—The Company Law Board has no jurisdiction to act as an investigating authority to ascertain whether a transfer deed was fabricated or signature forged or whether a false affidavit was filed before it. The petitioner was calling upon the CLB to exercise these powers in connection with a transfer. The CLB said that he was abusing the process of law by writing such letters after the lapse of 7 to 8 years and raising the same issue again and again knowing fully well that the CLB is not empowered under its Regulations to review its own orders. *Gopal Krishna Sengupta v. Hindustan Construction Co.*, (2002) 112 Com Cases 166 : (2002) 51 CLA 116 (CLB).

Intervention of Civil Court order.—The petitioner sent some shares to the company for dematerialisation. The company credited all his shares except 100 to his demat account. In respect of the 100 shares there was a decree in favour of another person who had filed a suit claiming title over those shares. Subsequently the company issued 1:1 bonus shares and 100 shares were not credited to his demat account. The petitioner sought a suitable order from the Company Law Board. It was held that civil court proceeding in respect of 100 shares was applicable to bonus shares also. There was no scope for any CLB order on the matter in question. *Pratibha Dilip Karnad v. Satyam Computer Services Ltd.*, (2001) 33 SCL 794 : (2001) 44 CLA 266 (CLB—N. Delhi). See also *Mahendra J. Ramani v. Sevil Ltd.*, (2001) 33 SCL 615 (CLB—Cal), controversey whether the documents were received by the company or not.

Jurisdiction of CLB over public companies.—In *Canara Bank Ltd. v. Mahanagar Telephone Nigam Ltd.*, (1998) 93 Com Cases 60 : (1998) 2 Comp LJ 359 : (1998) 29 CLA 214 : (1998) 16 SCL 178 (CLB—NB), a writ petition was filed in a High Court for an order of rectification of the register of members of a public company. The writ was dismissed *in limine* as not maintanable. Subsequently a petition was filed before the Company Law Board. It was held that the jurisdiction of CLB was to be considered as on the date of the petition to the CLB and not on the date of the petition to the High Court. No forum can confer jurisdiction on itself by the application of equitable considerations nor can the parties do so by agreement. There has to be a specific legal provision for conferring jurisdiction. The High Court had not remanded the matter to the Company Law Board. It had dismissed the petition as not maintainable. The proceeding before the CLB were *de novo* and not a continuation of the proceedings before the High Court.

The Company Law Board is no longer in a position to look into disputes between the parties to a transfer to which the company is not a party. Since a public company is bound to accept a transfer for which appropriate papers have been filed, the Company Law Board cannot go into matters like whether there had been a sale of the shares or not or whether the documents were genuine or forged. All such matters have now to be the subject-matter of a civil suit. *Charanjit Singh Ghumman v. Dr. Reddy's Laboratories Ltd.*, (1999) 21 SCL 71 : (1999) 33 CLA 308 : (1999) 97 Com Cases 360 : (1999) 3 Comp LJ 448 (CLB—SB).

In a suit by a shareholder in respect of his shares, there was an order of the civil court restraining the transfer to 'A'. The company by mistake showed A's name on the certifi-

cates as a shareholder. Bonus and rights shares were given to the subsequent transferees and holders. The mistake was discovered after three years. An application was made to the Company Law Board for rectification. The company had no objection. Rectification was accordingly ordered but no order was possible in respect of bonus and rights shares which had already gone out. *Bharat K. Gajjar v. Castrol India Ltd.*, (2003) 115 Com Cases 396 (CLB).

The Company Law Board cannot now look into the validity of an allotment of shares by a public company. The powers which it could have exercised under s. 111(4) cannot now be exercised by reason of S. 111-A in respect of public companies. *Gopal Krishna Banga v. Poona Industrial Hotel Ltd.*, (1999) 34 CLA 177 (Bom).

Where a petition in respect of a public company happened to be filed under S. 111, it was held that it would automatically be treated as filed under S. 111-A. *Bhuwaneshwar Nath Nigam v. Hindustan Lever Ltd.*, (2002) 111 Com Cases 590 : (2002) 49 CLA 85 : (2002) 38 SCL 124 (CLB).

Conduct of petitioner

A company changed name and declared a cut-off date within which the name on share certificates could be rectified and after which certificates in the original name were not to be a good delivery. The company found that the conduct of the petitioner and his broker in seeking rectification after the date was not proper. The petitioner was held to be not entitled to rectification but liberty was given to him to seek remedy against the stock broker in a civil court. *Dinesh Gandhi and Bakula Gandhi v. Bayer Diagnostics India Ltd.*, (2001) 4 Comp LJ 342 : (2001) 44 CLA 273 : (2002) 111 Com Cases 547 : (2002) 35 SCL 292 (CLB—Mumbai).

Who can apply

The right to object to a transfer which is available under sub-s. (3) is confined only to the five types of entities or/individuals mentioned in the sub-section, namely, a depository, company, participant, investor or SEBI. Entities or persons other than these have no *locus standi* under the sub-section. It has been held by the Bombay High Court in *M. Sreenivasulu Reddy v. Kishore R. Chhabaria*, (2000) 42 CLA 93 : (2001) 34 SCL 1 (Bom) that the provision means only to say that other persons cannot approach the Company Law Board but that does not mean that they cannot have access to a civil court which they might have had before. The remedy by way of filing a civil suit cannot be taken away inspite of the special provision in s. 111A(3). It is a settled legal position that the courts have to go slow when it comes to ousting of civil court jurisdiction and of the civil remedies available to citizens. Thus any person not falling in the list of s. 111A(3) who is aggrieved of the violation of SEBI Takeover Regulations can approach a civil court. An injunction can be granted to prevent exercise of rights of a shareholder in respect of shares acquired in violation of the Regulations except where the rights in question were acquired before SEBI Regulations came into force, for example, the right of getting debentures converted into shares acquired before the Regulations though the exercise of the rights took place after the Regulations came into force.

SEBI Directions on inter-depository transfer of beneficial ownership of securities

Provisions of section 10 of the Depositories Act, 1996 provides that notwithstanding anything contained in any other law, a depository shall be deemed to be registered owner for the purposes of effecting transfer of ownership of securities on behalf of beneficial owner.

As per the provisions of sub-section (2) of section 111A of the Companies Act, 1956, as amended by the Depositories Act of 1996, shares or debentures and any interest therein of a company are freely transferable.

Regulation 31 of the Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996 provides that every depository shall maintain continuous electronic means of communication with all its participants, issuers or issuer agents, as the case may be.

Section 19 of the Depositories Act empowers the SEBI to issue directions to issuers, registrars and share transfer agents and the depository after causing an enquiry to be made.

In view of the above legal provisions, and after causing an enquiry to be made and on being satisfied that it is necessary in the interest of investors as well as for orderly development of securities market and for expeditious inter-depository transfer of securities, the following directions in exercise of the powers conferred to the Board under the Depositories Act are issued to the issuers whose securities have been dematerialised and to their registrars and share transfer agents.

> "Inter-depository transfer of beneficial ownership of securities shall be effected by the depositories only after the change in registered ownership in favour of the transferee-depository has been effected by the issuer-company or the registrar and share transfer agent, as the case may be. The issuer-company or the Registrar to an issue and the share transfer agent, as the case may be, shall effect the necessary changes of the registered ownership of securities in their records and communicate the same to the depositories within two hours, of the receipt of the request for transfers."

The directive shall come into effect immediately. [*SMDRP/POLICY/CIR-13/99, dated 19th May, 1999, issued by the Securities and Exchange Board of India*]

Limitation under proviso to sub-section (2)

The shares or debentures of a public company are freely transferable. In case the transfer is refused within 2 months from the date on which instrument of transfer or intimation of transfer (transmission) is delivered to the company, the transferee may file an appeal to CLB. Although not stated, appeal may also be filed in case the company does not intimate the fate of transfer at all. No period of limitation has been prescribed for filing an appeal under the proviso to sub-section (2).

The Bombay High Court in its decision in *Finolex Industries Ltd. v. Anil Ramchand Chhabria,* (2000) 37 CLA 278 (Bom) has also adopted this view that the effect of the totality of the provisions of s. 111 and s. 111A is that the time limit of two months would not apply to public companies in the matter of rectification of their register of members under s. 111(2) (proviso). The court proceeded as follows : [at p. 292]

"Is section 111 only applicable to private limited companies in view of sub-section (14)? The provisions of the Depositories Act are in addition to and not in derogation of the existing provisions of the law. Therefore, it cannot be held that by virtue of section 111(14) the provisions of sub-sections (1), (2) and (4) of section 111 are not applicable to public companies. Sub-section (1) of section 111 makes it incumbent on the company to serve a notice of refusal of transfer within two months of the delivery of instrument of transfer or intimation of transmission. This provision is now incorporated in proviso to section 111A(2). But an additional benefit has been given to the shareholders in that that no limit is provided for filing the appeal against the refusal or neglect of the company or the depository to transfer the shares. For this reason section 111(3) has not been incorporated in section 111A(7) which provides the manner in which the applications are to be decided by the CLB under section 111A. Sub-section (14) of section 111 cannot exclude the application of sub-sections (1), (2) and (4) of section 111 to shares held in a public company as it would then be in conflict with section 28 of the Depositories Act. Under this section, the law made under the Depositories Act is in addition to and not in derogation of any law which is/was in force at the time when the Depositories Act was enacted. Therefore, restriction contained in sub-section (14) of section 111 would not apply to transfer and ownership of the shares of the public company held in the form of share certificates. Construed in this manner, the provision of sub-section (1) or section 111A would clearly mean that the remedy of rectification of register on transfer provided in section 111A would not be applicable to private companies. For the private limited companies, the remedies of appeal and rectification would remain under sections 111(2), (3) and (4). When an application is made under section 111 with regard to a private company, the CLB will deal with the same under the provisions of section 111. The limit of two months appeal as provided under sub-section (3) of section 111 would still be applicable to private companies." This ruling was referred to over the point of limitation in *Mani Credit Capital P. Ltd. v. Reliance Industries Ltd.,* (2002) 111 Com Cases 808.

The law of limitation as applicable to suits would apply here also. Where the period of limitation started running sometime in 1989 when share certificates and the transfer form

were returned to the petitioner because of forgery in the transfer form, the filing of a petition after a gap of eleven years had made the petition hopelessly time-barred. The same would have been true if a civil suit had been filed. Apart from these matters, the company was willing to rectify the register in respect of the shares in question. The company was ordered to do so accordingly. *Bharat K. Gajjar v. Castrol India Ltd.*, (2002) 38 SCL 298 (CLB—Mum.).

The petitioner sent shares to the company for consolidation and transfer. The company informed him that the shares in question had already been registered in the name of some one else. Five years after the date of this information, the petitioner approached the Company Law Board. It was held that the case was hopelessly time-barred and deserved to be dismissed on the ground of limitation alone. *Amarjeet Singh v. Reliance Industries Ltd.*, (2002) 40 SCL 939 (CLB—Mum.).

Limitation period under sub-section (3)

The application under sub-section (3) can only be made within two months from the date of transfer of any share or debenture held by a depository or from the date on which instrument of transfer or intimation of transmission was delivered to the company, as the case may be. An application made after the expiry of the said period of 2 months is not maintainable. CLB has no power to entertain the application filed belatedly unless it is accompanied by a prayer for condonation.

Condonation of delay.—An application under s. 5 of the Limitation Act, 1963 can be considered if the delay was not deliberate or due to gross negligence. *Bombay Dyeing & Mfg. Co. Ltd. v. Arun Kumar Bajoria*, (2001) 44 CLA 232 : (2001) 4 Comp LJ 115 : (2001) 34 SCL 320 : (2001) CLC 1508 (CLB—NR—N. Del).

Transfers involving fraud and period of limitation.—The two month period applies to normal transaction for transfer of shares and not to transactions in which the shareholder has been deprived of his shares by fraud or forgery and transfer effected. Explaining the complications caused by such a transaction and non-suitability of the remedy under s. 111A in *Sham Sunder Kukreja v. Hindustan Lever Ltd.*, (2001) 44 CLA 38 : (2001) 33 SCL 624 : (2001) 4 Comp LJ 305 (CLB—WR—Mumbai), the CLB said [at p. 47]: "Now that we have held that these shares have been fraudulently transferred and that but for the negligence/inaction on the part of the BBLIL, the shares could not have been transferred in the name of the respondent, the question of relief arises. In the normal circumstances, in view of the fraudulent transfers, we would have directed the company to rectify the register of members by deleting the names of persons holding the shares and to insert the name of the petitioner along with the first joint-holder. However, in the present case, the second respondent has already sold these shares and due to merger with the company, shares in the name of the company have been issued in respect of shares held in BBLIL. Further, in view of the dematerialisation of shares, the identity of the shares has been lost and as such the question of deleting the name of any present shareholder in respect of these shares is not possible. In the circumstances, considering the fact that the BBLIL had been squarely at fault in effecting the registration of transfer in the name of the second respondent, and that a shareholder cannot suffer on account of the same, we consider it appropriate to direct the first respondent-company with which BBLIL has merged, to pay the price of the impugned shares (which is equivalent to 166 shares of HLL) to the petitioner. The price of the shares shall be the one which was the highest in Mumbai Stock Exchange between the period of lodgment of the share certificates by the petitioner, *i.e.*, on 15th November, 1996 and the date of effecting the registration of transfer on 23rd April, 1997. In addition to this, we also award a cost of Rs. 10,000 to the petitioner. The price for the shares as compared to the above and the cost will be paid to the petitioner and the first joint-holder jointly within six weeks from the date of the receipt of this order."

Where there were allegations that shares were fraudulently transferred on the basis of forged transfer forms, the CLB held that strict time-limit was not to be applied. *Shailash Rajnikant Parekh v. Starline Travels P. Ltd.*, (2004) 118 Com Cases 145 (CLB).

Delay in registration of transfer and consequential matters.—Where documents for transfer of shares were sent by post and were lost and the company could not register the transfer for want of original documents, it was held that a bonus having been declared in the meantime, it was justificably paid to the transferor. The transferee had no remedy against the company. He could sue the transferor. *Pyariben M. Shah v. NIIT Ltd.*, (2002) 111 Com Cases 816 : (2002) 37 SCL 793 : (2000) 2 Comp LJ 518 : (2002) 51 CLA 292 (CLB).

Writ remedy

In the matter of a transfer of shares between promoters, a petition was filed before the Company Law Board and was subsequnetly withdrawn. The court said : "the petitioner did not evoke the alternative or effective remedy available under sectioin 111A which provides a wider remedy than a writ petition. Delay is one of the recognised grounds for refusal of a discretionary relief. The transfer of shares had taken place in 1997, the memorandum of understanding was of the year 1996 and the writ petition was filed in 2001, and the time within which an application was permitted to be filed under section 111A was only 30 days from the date of transfer of shares. The writ petition could not be entertained, since there was no averment in the affidavit that the petitioner and his family members had not received the consideration as contemplated under the memorandum of understanding, no relief could be granted. *K. Sreenivasa Rao v. Regional Director, SEBI*, (2002) 112 Com Cases 327 : (2002) 39 SCL 195 : 2002 CLC 1381 (AP).

Declaratory relief as to title

Relief under the section can be granted in connection with a transfer of shares for undoing a wrong thing or for doing a right thing, and not for a declaration as to who is the owner of the shares at the moment. A ruling on the point is to be seen in *Arun Kumar Malik v. Hindustan Lever Ltd.*, (2002) 112 Com Cases 464 : (2002) 49 CLB 353 : (2002) 39 SCL 963 (CLB). In this case no entry was struck off from the register of member, nor any wrong entry made. Thus, there was no ground for an order of rectification. The petition was filed only for seeking a declaration of title. A petition for such a purpose as that was held to be not maintainable. Liberty was given to the petitioner to file a civil suit for the purpose. The shares stood in the name of petitioner already.

Petition before CLB

An appeal under proviso to sub-section (2) or an application under sub-section (3) may be made by way of a petition to the concerned Double Member Bench of the Company Law Board as per procedure laid down in the CLB Regulations, 1991, as amended by the CLB (Amendment) Regulations, 1997 *vide Notification No.* GSR 433(E), dated 1-8-1997, alongwith a fee of Rs. 500 and accompanied by the following documents:

Where the company is petitioner

(1) Copy of the memorandum and articles of association.
(2) Latest audited balance-sheet and profit and loss account, auditors' report and directors' report.
(3) Authenticated copy of the extract of the Registrar of members.
(4) Copy of the resolution of the Board or Committee of Directors (where applicable).
(5) Any other relevant documents.
(6) Affidavit verifying the petition.
(7) Bank draft evidencing payment of application fee.
(8) Memorandum of appearance in Form No. 5 of Annexure I with copy of the Board Resolution or the executed Vakalatnama, as the case may be.
(9) Two extra copies of the petition.

Where the petition is made by any other person

(1) Documentary evidence in support of the Statement made in the petition including the copy of the letter written by the petitioner to the company for the purpose of registering the transfer of, or the transmission of the right to any shares or interest in, or debentures as also a copy of the letter of refusal of the company.

(2) Copies of the documents returned by the company.
(3) Any other relevant documents.
(4) Affidavit verifying the petition.
(5) Bank draft evidencing payment of application fee.
(6) Memorandum of appearance in Form No. 5 of Annexure I with a copy of the Board's resolution or the executed Vakalatnama, as the case may be.
(7) Two extra copies of the petition.

§ For text of the Company Law Board Regulations, 1991, refer *Appendix* 3.

Petition signed by second joint-holder only.—Where the petition was signed by the second joint-holder and not by the first, it was held to be not fatal to the petition. The second holder of the shares in question had the right to exercise all the rights of a shareholder. *Sham Sunder Kukerja v. Hindustan Lever Ltd.*, (2001) 44 CLA 38 : (2001) 33 SCL 624 : (2001) 4 Comp LJ 305 (CLB—Mum).

Transfer of shares of banking company.—Where the petitioner purchased only an insignificant number of shares of a banking company and the company asked him questions about his income tax matters and sources of finance, it was held that since the RBI Guidelines applied only when the purchase of shares was intended to acquire controlling interest, the bank was wrong in asking the questions. It was bound to accept the transfer. *T.S. Premkumar v. Tamilnad Mercantile Bank Ltd.*, (2001) 33 SCL 802 : (2001) 44 CLA 259 (CLB—Chennai).

Listing Agreement requirements for transfer of Securities

Clause 12A.—The following conditions in the listing Agreement relating to registration of transfer of securities may be noted:

12A. (1a) The company agrees that in respect of transfer of shares where the company has not effected transfer of shares within 1 month or where the company has failed to communicate to the transferee any valid objection to the transfer within the stipulated time period of 1 month, the company shall compensate the aggrieved party for the opportunity losses caused during the period of the delay.

In addition, the company keeping in view the provisions of Section 206A of the Companies Act and Section 27 of the Securities Contracts (Regulation) Act, 1956, provide all benefits (i.e. bonus shares, right shares, dividend) which accrued to the investor during the intervening period on account of such delay. [*Issued by SEBI No. SMD/Policy/Cir-10/2002, dated 7-5-2002*].

Clause 47.—Clause 47 inserted in the Listing Agreement (w.e.f. 27-7-1998) gives effect to the Chandrasekaran Committee regarding transfer of share. The Governing Board of the Stock Exchange, Mumbai has approved and inserted a new Clause 47 in the Listing Agreement. This Clause comes into effect immediately and is reproduced hereunder for general information.

"47. The company agrees—

(*a*) to appoint the company secretary to act as Compliance Officer who will be responsible for monitoring the share transfer process and report to the Company's Board in each meeting. The compliance officer will directly lilies with the authorities such as SEBI, Stock Exchanges, Registrar of Companies, *etc.*, and investors with respect to implementation of various clauses, rules, regulations and other directives of such authorities and investor service and complaints of related matter;

(*b*) to undertake a due diligence survey to ascertain whether the Registrars and Share Transfer Agent/s (RTA) and/or In-house Share Transfer facility, as the case may be, are sufficiently equipped with infrastructure facilities such as adequate manpower, computer hardware and software, office space, documents handling facility, *etc.*, to serve the shareholders;

(*c*) that it will ensure that the RTA and/or the In-house Share Transfer facility, as the case may be, produces a certificate from a practising Company Secretary within one month of the end of each half of the financial year, certifying that all certificates have been issued within one month of the date of lodgement for transfer, sub-division, consolidation, renewal, exchange or endorsement of calls/allotment monies and a copy of the same shall be made available to the Exchange within 24 hours of the receipt of the certificate by the Company;

(*d*) to furnish to the Exchange both by way of floppy disks and printed details, within 48 hours of its getting information regarding loss of share certificates and issue of the duplicate certificates;

(*e*) to maintain copies of Memorandum of Understanding entered into with the RTA setting out their mutual responsibilities, at the Registered Office of the company for public inspection and the company further agrees to submit within 48 hours a copy of the same to the Exchange for its records".

Also refer to clauses 10 to 17 of the Listing Agreement relating to transfer of securities.

§ For text of the Listing Agreement, see *Appendix* 252.

SEBI (Registrars to an Issue and Share Transfer Agents) Regulations, 1993

Appointment of Compliance Officer.—(1) Every registrar to an issue and share transfer agents shall appoint a compliance officer who shall be responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions etc., issued by the Board or the Central Government and for redressal of investors' grievances.

(2) The compliance officer shall immediately and independently report to the Board any non-compliance observed by him. [*Reg. 15-A*]

S. 112. Certification of transfers.—(1) The certification by a company of any instrument of transfer of shares in, or debentures of, the company, shall be taken as a representation by the company to any person acting on the faith of the certification that there have been produced to the company such documents as on the face of them show a *prima facie* title to the shares or debentures in the transferor named in the instrument of transfer, but not as a representation that the transferor has any title to the shares or debentures.

(2) Where any person acts on the faith of an erroneous certification made by a company negligently, the company shall be under the same liability to him as if the certification has been made fraudulently.

(3) For the purposes of this section—

(a) an instrument of transfer shall be deemed to be certificated if it bears the words "certificate lodged" or words to the like effect;

(b) the certification of an instrument of transfer shall be deemed to be made by a company, if—

(i) the person issuing the certificated instrument is a person authorised to issue such instruments of transfer on the company's behalf; and

(ii) the certification is signed by any officer or servant of the company or any other person, authorised to certificate transfers on the company's behalf, or if a body corporate has been so authorised, by any officer or servant of that body corporate;

(c) certification shall be deemed to be signed by any person, if it purports to be authenticated by his signature unless it is shown that the signature was placed there neither by himself nor by any person authorised to use the signature for the purpose of certificating transfers on the company's behalf.

NOTES

Eng. Act, 1948 : Sec. 79
Eng. Act, 1985 : Sec. 184

Companies Act, 1956

This section gives statutory recognition to general practice and adopts the English section with a few minor drafting improvements.

Companies (Amendment) Act, 2000

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*]

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*].

Scope of Section

Where a shareholder sells a portion only of the shares comprised in one certificate or sells such shares to several purchasers, it is obviously not always convenient or practicable for the share certificate to accompany each transfer. In such case or where the buying broker will not accept the mere transfer instrument, the seller's broker will present the transfer or transfers duly executed by the seller and accompanied by the certificate of the entire shares with a request for 'certification' by the company's office to the effect that the share certificate for the shares bearing the specified numbers is lodged with and retained by the company; of course there is no statutory duty on the company to make the certification. But it is usually done to facilitate dealing in the shares of the company.

The practice is thus briefly and neatly explained in PALMER'S COMPANY GUIDE, 36th Edn., pages 49-51:

"Certification of transfers"

When the holder of shares executes a transfer thereof, it is for the transferee to get the transfer registered and in order to do this, he must be prepared to hand over or to procure the handing over, to the company of the transferor's certificate of title to such shares. If the certificate comprises the shares transferred and no more, it can, of course, be handed over with the transfer to transferee but very commonly, the certificate includes other shares. For example, the certificate may certify that A is the holder of 100 shares; if he transfers only 50, he retains 50, and, therefore, does not want to hand over his certificate; and again, if having 100 shares, he sells 50 to B and 50 to C, he cannot hand over the certificate to both. In such cases the transferor usually lodges his certificate with the company and then at his request, or at the request of his broker, the secretary certifies the transfers (before they are handed over to the transferee) by stamping in the margin of the form of certificate, and signing the same. The following forms are used.

A. Certificate lodged.

For the .....Company, Limited.

.....Secretary.

Certificate for ..... shares has been lodged at the company's office.

Date..... .....Secretary

Form B is preferable. Where it is used, the number of shares in the transfer will be inserted in the blank, though the number in the certificate is larger.

So, too, if A transfers to B 50 shares and the transfer so certified is accompanied by a certificate in A's name, and afterwards, before the transfer is registered, B transfers to C, then according to the practice of some companies the secretary, at the request of B, will certify his transfer to C, provided the transfer to B has been lodged for registration, and any receipt therefor given up.

Certification, a representation and liability of company

The certification is a representation by the company to any person acting on the faith of it that there have been produced to the company such documents, as on the face of them, show a *prima facie* title in the transferor, but not a representation that the transferor has any title to the shares. In giving such certifications the secretary is not supposed to do more than look at the documents produced. If they appear to be in order, he certifies; if they are not, he refuses to certify; but he is not bound to inquire whether the documents produced to him are genuine or not, or whether the various transfers are valid or invalid in point of law. He does not warrant the title of the transferor, or the validity, in point of law, of the various documents which, together, purport to establish his title. If a false certification is made negligently by the company and any person acts on the faith of it to his detriment, the company is liable to that person for the loss he thereby sustains.

This rule applies only where the person certifying is authorised by the company to do so, *e.g.*, the company's authorised registrar or secretaries of transfer of shares. It should, however, be noted that the secretary or the company's registrar of shares is not merely by virtue of his office authorised to certify. This was the position taken by the court in the early case of *Bishop v. Balkis Consolidated Co.*, (1890) 25 QBD 512. But in view of the decision in *Panorama Developments (Guildford) v. Fidelis Furnishing Fabrics Ltd.*, (1971) 2 QB 711 : (1971) 3 All ER 16 (CA); giving an enlarged version of the powers of a secretary, the position taken by the court in the *Bishops* case becomes open to question. If there is no such authority and the transferee is not able to plead in his favour the protection of the doctrine of the indoor management, the company will not be liable. There is, however, the presumption that the person issuing the certificate was duly authorised by the company and, therefore, burden to show that he was not so authorised lies on the company. The provisions of sub-section (3) largely nullify the decisions of the HOUSE OF LORDS in *George Whitechurch Ltd. v. Cavanagh*, (1902) AC 117 and *Kleinwort Sons & Co. v. Associated Automatic Corporation*, (1934) 151 LT 1.

Certification of debenture.—These provisions apply equally to certification on transfer of debentures.

A transfer certified as above is by the rules of the London Stock Exchange accepted as a good delivery of the shares to a buyer, and apart from those rules a buyer requires the certificate or a certified transfer, seeing that the articles generally provide for the production of the certificate before a transfer will be registered. A record of certifications should be kept. See Rule 19(3) of the Securities Contracts (Regulation) Rules, 1957.

Certificate where a transferor has no evidence of title

Sometimes a secretary is called on to certify a transfer where the transferor has not as yet, obtained any certificate of title—*e.g.* where he is the original allottee but has not taken out a certificate. There seems no objection to certifying the transfer in such a case,

provided that the transferor is absolutely entitled to call for a certificate, and that he gives up or allows a note to be placed on his allotment letter.

If the company, after certificating, returns the certificate by mistake to the transferor, and transferor pledges it in fraud of transferee, this, it seems gives the pledgee no ground of action against the company. *Longman v. Bath Electric Tramways,* (1905) 1 Ch 646.

Certificate for balance

Where the certificate is lodged with a view to the transfer of part only of the shares comprised therein, the company in the due course issues to the transferor a fresh certificate for the balance; or, according to the practice of some companies, endorses on the deposited certificate particulars of the shares transferred, and then returns the certificate to the depositor. Sometimes on the deposit and before the issue of a fresh certificate, the depositor is given a balance ticket. This paragraph was quoted with approval in *Kumar Exporters Pvt. Ltd. v. Naini Oxygen Acetylene & Gas Ltd.,* (1985) 58 Com Cases 97 (All).

Certification neither guarantee nor warranty

"Certification" gives neither warranty of the transferor's title, nor any guarantee on the part of the company. See *Longman v. Bath Electric Tramways,* (1905) 1 Ch 646. But as per sub-section (2), where a person acts on the faith of a false certification, the company will be liable in damages for any loss suffered by him.

It has to be noted that while certification imposes some very serious liabilities on a company, there is no statutory duty on the part of a company to certify transfers at all; nor is any fee charged for giving this facility.

The section applies only to certification by the company. In the case of shares dealt in any Stock Exchange, any certification by an official of the Stock Exchange will make the Stock Exchange liable, in the event of fraud or negligence on the part of any of its officials.

Transfer under court order

An application was filed either for an order of transfer of shares or for return of consideration money. The Supreme Court ordered *status quo* and remanded the matter to the High Court for reconsideration. The High Court ordered that 50% of the total number of shares be sold by public offer. The dispute as to title was still pending before the High Court. The High Court allowed by way of interim arrangement transfer to the applicants to the extent of 50% of the total number of shares. *K.K. Modi v. M.K. Modi,* 2003 CLC 1263 (Delhi).

Secretarial Practice Notes : Certification of transfer

Where certification of transfer was done, check whether:

(i) the certification on the instrument of transfer were to the effect "certificate lodged"?

(ii) certification was done by duly authorised person?

Documents Involved: 1. Relevant correspondence, 2. Share transfer register, 3. Share Transfer Form.

Issue of Certificate of Shares, etc.

S. 113. Limitation of time for issue of certificates.—[1][(1) Every company, unless prohibited by any provision of law or of any order of any court, tribunal or

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1. Subs. by the Companies (Amendment) Act, 1988, s. 17(a) w.e.f. 15-6-1988 *vide* GSR No. 559(E) dated 10-6-1988, for the words "(1) Every company shall, within three months after the allotment of any of its shares, debentures or debenture stock, and within two months after the application for the registration of the transfer of any such shares debentures or debenture stock, complete and have ready for delivery the certificates, of all shares, the debentures, and the certificates of all debenture stock allotted or transferred, unless the conditions of issue of the shares, debentures or debenture stock otherwise provide".

other authority, shall, within three months after the allotment of any of its shares, debentures or debenture stock, and within two months after the application for the registration of the transfer of any such shares, debentures or debenture stock, deliver, in accordance with the procedure laid down in section 53, the certificates of all shares, debentures and certificates of debenture stocks allotted or transferred:]

[2][*Provided* that the [3][*Central Government*] may, on an application[4] being made to it in this behalf by the company, extend any of the periods within which the certificates of all debentures and debenture stocks, allotted or transferred shall be delivered under this sub-section, to a further period not exceeding nine months, if it is satisfied that it is not possible for the company to deliver such certificates within the said periods.]

The expression "transfer", for the purposes of this sub-section, means a transfer duly stamped and otherwise valid, and does not include any transfer which the company is for any reason entitled to refuse to register and does not register.

(2) If default is made in complying with sub-section (1), the company, and every officer of the company who is in default, shall be punishable with fine which may extend to [5][five thousand rupees] for every day during which the default continues.

(3) If any company on which a notice has been served requiring it to make good any default in complying with the provisions of sub-section (1), fails to make good the default within ten days after the service of the notice, the [6][*Central Government*] may, on the application[7] of the person entitled to have the certificates or the debentures delivered to him, make an order directing the company and any officer of the company to make good the default within such time as may be specified in the order; and any such order may provide that all costs of and incidental to the application shall be borne by the company or by any officer of the company responsible for the default.

[8][(4) Notwithstanding anything contained in sub-section (1), where the securities are dealt with in a depository, the company shall intimate the details of allotment of securities to depository immediately on allotment of such securities.]

NOTES

Eng. Act, 1948 : Sec. 80
Eng. Act, 1985 : Sec. 185

Previous Act : Sec. 108

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2. Ins. by the Companies (Amendment) Act, 1988 (w.e.f. 16-5-1988).
3. **Subs. for "Company Law Board" by the Companies (Second Amendment) Act, 2002 (11 of 2003), s. 16.**
4. Such application shall be accompanied by a fee of Rs. 500/- under CLB (Fees on Applications & Petitions) Rules 1991, see *Appendix* 6.
5. The words "five hundred rupees" substituted by the Companies (Amendment) Act, 2000, (53 of 2000) s. 46 (w.e.f. 13-12-2000).
6. **Subs. for "Company Law Board" by the Companies (Second Amendment) Act, 2002 (11 of 2003), s. 16. Earlier subs. by the Companies (Amendment) Act, 1988, (w.e.f. 31-5-1991) *vide* GSR dated 31-5- 1991, for the word "Court".**
7. With fee of Rs. 50/- under CLB (Fees on Applications & Petitions) Rules, 1991, see *Appendix* 6.
8. Ins. by the Depositories Act, 1996 (w.e.f. 20-9-1995).

General Note : As and when the Companies (Second Amendment) Act, 2002 (11 of 2003) comes into force, the power under this section shall become transferred to the Central Government to be exercised by it in place of the Company Law Board. The commentary should be read keeping this change in mind.

Companies (Amendment) Act of 1988

Sub-section (1) has been amended by Companies (Amendment) Act, 1988 (w.e.f. 15-6-1988). Clause 17 of Notes on clauses stated that the amendment "seeks to remove a lacuna, advantage of which was often taken by Companies to delay the issue of certificates of shares or debentures within the period of three months mentioned in section 113. This clause also seeks to transfer from the Court, and to vest in the Company Law Board, the power to direct a company or any of its officers to make good the default in complying with the provisions of this section."

Depositories Act, 1996

Sub-section (4) has been inserted by the Depositories Act, 1996 to provide that in case the securities of a company are dealt with in a depository, the company will intimate details of allotments made to the depository immediately. Under the said Act the depository is deemed to be a registered owner of securities in the books of the issuer company. The name of investor will appear on the records of the depository, as beneficial owner, in respect of securities held by him, having all the rights and liabilities attached with securities.

In view of changes made by the Depositories Act, 1996 there will neither be a share certificate or transfer deed under depository made and the provisions of section 113 have been rendered meaningless in that context.

Companies (Amendment) Act, 2000

Penalty enhanced.—The Amendment Act of 2000 enhanced the penalty amount from 500 rupees to 5000 rupees under sub-section (2).

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*]

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*].

Companies (Second Amendment) Act, 2002 [11 of 2003]

The powers of Company Law Board under this section have been conferred on the Central Government. Consequential changes have accordingly been made in the section. The Bill initially sought to vest the powers in the Tribunal constituted under Part IB of the Act. Notes on Clauses of the Bill stated thus:

Notes on Clause.—This clause seeks to amend sections 111, 111A, 113, 117B, 117C and 118 of the Companies Act, 1956 relating to power to refuse registration of transfer of shares or interest of a Member or debentures and appeal against such refusal, rectification of register on transfer, limitation of time for issue of certificates, appointment of debenture trustees and duties of debenture trustees, liability of company to create security and debenture redemption reserve and right to obtain copies of and inspect trust deed. The Company Law Board has been conferred upon certain powers under these sections. It is proposed to confer these powers of the Company Law Board upon the Tribunal. These amendments are of consequential nature. (*Clause* 14 of the Companies (Amendment) Bill, 2001).

Scope of Section

Section 113 applies only to certificates of shares, *etc.*, and not to letters of allotment. *Hindustan Development Corpn. Ltd., Calcutta, Re,* (1994) 79 Com Cases 207 (CLB).

A company was permitted to withdraw its application for extension of time when it subsequently learned that the provisions were not applicable to certificates for bonds not coming within the meaning of debentures. *Mahanagar Telephone Nigam Ltd., Re,* (1993) 3 Comp LJ 239 (CLB).

Issue of certificates of shares and debentures [Sub-section (1)]

A company whose shares are not held in depository form is required not only to keep the certificates ready for delivery, but also to deliver the same to the allottee within three months from the date of allotment, and to the transferee within two months of the making of the application for the registration of the transfer of shares, debentures or debenture stock. This, however, is subject to any proceedings pending before any Court, tribunal or other authority, including proceedings under section 111 or S. 111A before the Company Law Board. Further, in case of transfer of shares or debentures, the duty to deliver the certificate within two months after the application for registration of transfer arises only when the instrument and/or application of transfer, as received, is duly stamped and is otherwise valid. The CLB has been empowered to extend the period of delivery of certificate(s) of debentures (or debenture stock) in appropriate cases for a further period not exceeding 9 months. It may be noted that CLB has no power to extend the time in respect of delay in delivering the Share Certificates.

Where the securities are dealt with in a depository the company is required to intimate the details of allotments to the depository immediately on allotment of such securities. [sub-section (4)].

Duty to deliver certificates of shares and debentures [Sub-section (1)]

The following passage from RAMAIYA'S GUIDE TO THE COMPANIES ACT, 10th Edn. 1984, page 311 received judicial approval of the Delhi High Court in *Trishla Jain v. Oswal Agro Mills Ltd.*, (1990) 67 Com Cases 125 (Del):

"It has been held by the Calcutta High Court [*In re, Asiatic Oxygen Ltd.*, (1972) 42 Com Cases 602 : AIR 1972 Cal 50], that the duty, under that section is only to complete and keep ready the certificate of shares and the duty does not further extend to delivering the certificate to the person entitled. This, however, is too narrow an interpretation of the words "complete and keep ready". Both the title to the section and the Companies (Issue of Share Certificate) Rules use the words "issue of share certificates" which necessarily includes delivery." The Delhi High Court held that the aforesaid words include delivery. A person entitled to have the certificate or the debentures delivered to him under section 113(3) of the Act is also entitled to apply for delivery of the same. See also *PNB Mutual Fund v. M.S. Shoes East Ltd.*, (1998) 16 SCL 627 (CLB–N. Delhi), where the company was directed to deliver debenture certificates.

The Amendment Act of 1988 has made it a specific duty of the company to deliver the requisite certificates within the time delimited by sub-section (1).

Where in a petition for prevention of oppression, one of the allegations was that share certificates of the original allotment were not delivered to the petitioners but records showed that they were despatched, the CLB accepted the assurance of the controlling group that duplicates would be given to the petitioners in fulfilment of their duty under this section. *Suryakant Gupta v. Rajaram Corn Products (Punjab) Ltd.*, (2001) 2 Comp LJ 155 : (2001) 41 CLA 284 : (2001) 31 SCL 120 : (2002) 108 Com Cases 133 (CLB—PB—N. Del).

Letters of allotment not included.—The time-limits set by the section are applicable to the issue of certificates of shares and debentures and not to letters of allotment. *Hindustan Development Corpn. Ltd., Re,* (1994) 79 Com Cases 207 (CLB— Cal).

Issue of refund orders, allotment letters/certificates, and letters of offer by registered post

Department's Circular.—The Government has been receiving complaints from the investing public regarding non-receipt of refund orders, allotment letters, share certificates, rights of offer and dividend warrants. In this connection, it may be stated that the Ministry of Finance, Department of Economic Affairs, *vide* their *Circular letter No.* 8/15/SE/86-B, dated 3rd June, 1986, addressed to all stock exchanges, informed that the Government has decided that henceforth all companies listed or seeking enlistment on stock exchanges, shall issue refund orders, allotment letters/certificates only by registered *post.* It has now been considered necessary that with a view to protect the interests of investors, the letters of offer for rights issue be also issued to the shareholders by registered post, in future. You are, therefore, requested to ensure strict compliance with these guidelines by your constituent member companies. [*Circular No.* 6 of 1992, dated 3-9-1992].

Physical share certificates

SEBI Circular.—SEBI has mandated that all the shares allotted under new initial public offerings (IPOs) will be traded in demat form only in all the exchanges. Investors, however, have the right to obtain and hold physical share certificate, though these will need to be dematerialised before sale of securities. Currently, the listing agreement provides that the physical share certificates are to be issued in market lots only. It has now been decided that in the case of IPOs the issuer company may issue a single share certificate to any investor who wishes to obtain physical share certificates unless otherwise specifically requested by him. [*SMDRP/Policy/Cir-12/01 dt. 28-2-2001, issued by SEBI*]

Despatch of share certificates on fictitious applications to be kept in abeyance

Where it is suspected that applications for shares are fictitious, the allotments thereon would be completed, and dispatch of share certificates/credit to demat account would be kept in abeyance till establishing the identity and genuineness of the applicant. Only after satisfactory verification on the genuineness of the applicant, the shares would be credited/released to the allottees. In the intervening period, the investors would be given an option to sell the shares kept in abeyance if he so desires. However, the proceeds of such sale would remain frozen and would be released only after the completion of verification and identification of the applicants. Prosecutions under Section 68A of the Companies Act should also be initiated where appropriate. [*SEBI Press Release No. 21/2001, dt. 31-1-2001*].

§ See also Notes under section 73, *ante.*

Delay in delivery of debenture certificates

Under the proviso to sub-section (1), CLB can condone the delay in the delivery of debenture certificate after allotment upto 12 months and in case of delay in transfer after lodgment of instrument of transfer by 11 months. In case the delay is condoned, no prosecution will lie under sub-section (2).

Debenture certificates have to be delivered within 3 months after allotment. There is no requirement under the law regarding the period within which allotment is to be made.

Extension for nine months by CLB [Sub-section (1) Proviso]

The Company Law Board has been empowered to extend the time to a further period not exceeding nine months. It has been held that the word "further" should be taken to mean any period in addition to the already granted period of two months (transfers) and 3 months (allotment). *Classic Financial Services and Enterprises Ltd., Re,* (1995) 3 Comp LJ 225 (CLB—Cal).

Registrar is an aggrieved person

A complaint lies only at the instance of the aggrieved shareholder or debentureholder. It cannot be filed by the Registrar of Companies. The Registrar cannot be the aggrieved party under the section. There was no complaint by any shareholder that he was put to any inconvenience or loss by reason of the delay. Even otherwise the complaint was filed by the Registrar long after six months without any convincing explanation for the delay. This was the decision of Madras High Court in *Registrar of Companies v. Rajashree Sugars and Chemicals Ltd.*, (1998) 94 Com Cases 213 (Mad) : (1999) 32 CLA 255 :

(1998) 5 Comp LJ 379. To the same effect was the decision in *Nestle India Ltd. v. State,* (1999) 4 Comp LJ 446 : (2000) 36 CLA 280 : (2000) 101 Com Cases 263 (Delhi). Here also the complaint was filed by the Registrar and that too after two years. The court rejected it because the Registrar was not an aggrieved person and the cause was already time-barred.

The decision of the Madras High Court in *Registrar of Companies v. Rajashree Sugars and Chemicals Ltd., (Supra)* was **set aside** and that of Delhi High Court in *Nestle* Case was **overruled** by the Supreme Court in *Registrar of Comppanies v. Rajshree Sugars & Chemicals Ltd.* (2000) 2 Comp LJ 369 : (2000) 37 CLA 400 : (2000) 101 Com Cases 271 : AIR 2000 SC 1643. The Court said that the Registrar is an aggrieved person within the meaning of s. 113(2) and, therefore, competent to file a complaint. The case was sent back for trial on merits. The Supreme Court said [at p. 375] that the High Court erred in construing the provisions of section 113(2) with reference to section 113(3). The latter deals with the civil liability of the company and its officers for a breach of section 113(1) at the instance of the transferee of the shares. Section 113(2) deals with the criminal liability arising out of a violation of section 113(1). The objects of the two sub-sections are different. Section 113(3) is primarily conpensatory in nature whereas section 113(2) is punitive. An application under section 113(3) can only be made by the transferee. A transferee who is not an existing shareholder of the company cannot file a complaint under section 113(2) at all.

Jurisdiction for complaint

Criminal courts have jurisdiction to entertain a complaint for an offene under section 113(2). *Bank of Rajasthan Ltd. v. State of Bihar,* (2000) 26 SCL 1 (Pat).

The failure to deliver certificates within the time delimited by the provision constitutes an offence of which it has been said that it becomes complete at the place of the company's Registered Office and, therefore, the courts at that place alone would have jurisdiction. *ICICI Ltd. v. H.V. Jayaram,* (1998) 94 Com Cases 409 (Kant) : (1998) 4 Comp LJ 412. The court followed the principle of law stated in *Hanuman Pd. Gupta v. Hiralal,* (1970) 40 Com Cases 1053 (SC). The decision of the Karnataka High Court in *ICICI Ltd. v. H.V. Jayaram* was **affirmed** by the Supreme Court in *H.V. Jayaram v. ICICI Ltd.,* (2000) 99 Com Cases 341 : (2000) 36 CLA 1 (SC) and **followed** in *India Petro Chemicals Corpn. Ltd. v. State of Rajasthan,* (2000) 39 CLA 70 : (2001) 29 SCL 234 : (2001) 104 Com Cases 285 : (2000) 6 Comp LJ 52 (Raj); *Zee Tele Films Ltd. v. State of AP,* 2000 CLC 1836 : (2000) 27 SCL 389 : (2002) 110 Com Cases 884 (AP), in this case the office was at Mumbai, the Special Judge for Economic Offences at Hyderabad had no jurisdiction. Quite obviously, therefore, the rulings of the High Courts in the following cases have also become **affected** : *Ranbaxy Laboratories Ltd. v. Indra Lala,* (1997) 88 Com Cases 348 (Raj); *Hindustan Development Corpn. Ltd. v. Khushal Chand Bader,* (1998) 29 CLA 222 : (1998) 1 Comp LJ 222 (Raj); *Herdilia v. Aparjita Chambers,* (2000) 99 Com Cases 145 : (2000) 1 Comp LJ 249 (Raj). In these cases complaints were entertained at the place of the residence of the person who was to receive the certificate.

In *Herdilia Unimers Ltd. v. Renu Jain,* (1998) 92 Com Cases 841 (Raj) the Rajasthan High Court gave the ruling that the question whether the court at Jaipur has territorial jurisdiction in respect of the company which had its registered office at Bombay was a question of fact which could not be examined in a petition under S. 113 of the Companies Act.

Where the shares were dispatched from West Bengal to the registered office of the company at Mumbai and the company contended that it had sent the shares from Mumbai to West Bengal, the court said that it would have to be considered on the facts of the case to see whether a part of the cause of action had arisen in West Bengal. *Inter Sales v. Reliance Industries Ltd.,* (1999) 35 CLA 370, 376 (Cal). Another decision to the same effect is *C.R. Bhansali (Dr.) v. V.K. Ramesh,* (2001) 104 Com Cases 732 : 2001 CLC 409 :

(2001) 44 CLA 69 : (2001) 33 SCL 386 (Kant) namely, jurisdiction lies at the place of the company's registered office.

Quashing of complaint.—Where a complaint disclosed an offence under the section and the person charged was not able to show any ground for quashing the complaint without trial, the court asked the Magistrate not to insist upon the personal appearance of the person concerned and allow their appearance through counsel. *Anil D. Ambani v. Santosh Tyagi,* (2000) 1 Comp LJ 243 (Raj); *Dhirubhai H. Ambani v. Sonia Sethi,* (2001) 106 Com Cases 486 : (2001) 3 Comp LJ 75 (MP).

Nature and effect of share certificate

A share certificate "is a declaration by the company to all the world that the person in whose name the certificate is made out and to whom it is given, is a shareholder in the company and it is given by the company with the intention that it shall be so used by the person to whom it is given, and acted upon in the sale and transfer of shares" COCKBURN, J., *Re, Bahia, etc., Ry.,* (1868) LR 3 QB 584 at 585; *Ghanshyam Chaturbhuj v. Industrial Ceramic Pvt. Ltd.,* (1990) 68 Com Cases 36 (Mad).

A certificate under the common seal of the company is *prima facie* evidence of the title of the member to the shares specified therein. The certificate is the only documentary evidence of title in the possession of the shareholder. It declares to all the world that the person named therein is the registered holder of the shares and that the shares are paid up to the extent mentioned in it. But it is not a warranty of title by the company issuing it. This gives rise to two estoppels against the company, namely, *estoppel as to title*, which means that the company cannot deny as against an innocent purchaser of shares that the share certificate was issued by mistake; *estoppel as to payment*, which means that the company cannot say as against an innocent purchaser of shares that the amount of payment shown on the certificate was entered by mistake. *Cf. Balkis Consolidated Co. Ltd. v. Tomkinson,* (1893) AC 396 (HL); *Bloomenthal v. Ford,* (1897) AC 156 (HL).

"Dematerialised shares as evidence"

The rule that the company is liable to any person who has acquired shares relying on the certificates issued by the company may not apply in respect of uncertificated (dematerialised) shares. Because the company does not issue share certificates. But to the extent to which the company has to maintain its register of members, the contents of the register will constitute *prima facie* evidence of title, whether such register by itself, without the issue of share certificate, will constitute an estoppel against the company will be difficult to assert. The buyer may not have consulted the register before going in for the transfer. There is no rule that records kept by the Depository in relation to uncertificated shares are *prima facie* evidence of title. The company has appointed the computerised system for settlement of transactions in shares. The mechanism of the system relies on the data which was originally taken from the company's register. It is doubtful whether this connection with the company's register would amount to representation to the market. There are now two registers. The issue register which is maintained by the company and the operator register kept by the Depository. The company's issue register carries all the entries relating to both uncertificated and certificated shares. To that extent it continues to be a *prima facie* evidence of title. Once the particulars in the operator register change because of subsequent transactions, the company's register, to that extent, goes out of date and ceases to be *prima-facie* evidence.

A Depository may become liable if shares are transferred to a person under forged instructions, because this can happen only when the Depository fails to keep its computer net work system out of the reach of undesirable elements. The Depository can safeguard itself from liability by giving information about the manipulator. See Dr. Eva Micheler, *Farewell Quasi-Negotiability? Legal Title and Transfer of Shares in a paperless World,* 2002 JBL 358 at p. 373.

For a study of the following matters relating to share certificates:

1. *Estoppel as to title*
2. *Estoppel as to payment*
3. *No estoppel by dividend*
4. *No estoppel through forged certificate*
5. *Damages against company for wrong certificate*
6. *Liability of directors*
7. *Split certificates and*
8. *Duplicate certificates*

§ See Notes under Section 84, *ante.*

Penalty of default [Sub-section (2)]

The penalty for default under the section is fine which may extend to Rs. 5,000 for every day during which the default continues.

The default in complying with the requirement of the section is an offence of continuing nature and therefore the provisions of section 472 of the Criminal Procedure Code, 1973, would not be applicable up to the period that the default continues. *Ghanshyam Chaturbhuj v. Industrial Ceramics P. Ltd.,* (1990) 68 Com Cases 36 (Mad); *Herditia Unimers Ltd. v. Renu Jain,* (1998) 92 Com Cases 841 : (1995) 4 Comp LJ 45 (Raj). Though the Company Law Board has been given the power to extend the period for delivery of certificates, punishment for default, if any, would be in the domain of the courts only. The allottee of shares, who makes the complaint, may have to produce his allotment letter in support of his claim. But it would also be enough to show that the duly signed share certificates were ready in the office of the company and his name appeared in the register maintained for that purpose. The despatch of share certificates to an allottee by a letter, which is properly addressed and stamped, creates a presumption of due delivery. But it is rebuttable presumption. The allottee can show that he never received any despatch. The person who is styled as the president of the company can also be an officer in default unless he shows some different arrangement within the terms of section 5. *Herdilia Unimers Ltd. v. Renu Jain (Smt.),* (1995) 4 Comp LJ 45 : (1998) 92 Com Cases 841 (Raj). The court further held the mere fact that a company has appointed transfer agents and authorised them to carry out the transfer work does not give a complete immunity to the company from its liability. See also *Ramesh Chandra Manilal Kotla v. State of Gujarat,* (1998) 5 Comp LJ 217 : (1998) 30 CLA 313 (Guj) [*discussed hereafter*]. The company, its transfer agents, directors and other officers were allowed to go in for compounding by paying Rs. Twenty-six lakhs and twenty thousand in the aggregate. *Reliance Industries Ltd., Re,* (1997) 89 Com Cases 465 (CLB—WB).

A person purchased some shares and applied to the company for registering him as a shareholder. On the company's failure to do so within the time-limit set by s. 113, he filed a complaint before a magistrate for violation of s. 113. The complaint was entertained but had to be dismissed because no proof was offered to show that the person proceeded against was the managing director of the company. *Federal Bank Ltd. v. Sarala Devi Rathi (Smt.),* (1997) 88 Com Cases 323, 325 (Raj).

A prosecution under the section was quashed where the number and value of the securities involved were trivial and the transferee had not filed any complaint. The matter was raised only by the Registrar of Companies and that too after expiry of the period of limitation. *Nestle India Ltd. v. State,* (2000) 36 CLA 280 (Delhi).

Where the documents are posted within the prescribed time, that would be sufficient compliance with the requirement of the section and there would be no offence *Jayaram (H.V.) v. ICICI Ltd.,* (2000) 99 Com Cases 341 : (2000) 36 CLA 1 : (2000) 84 FLR 436 (SC).

Order for refund of money with interest.—Where the company did not issue the requisite share certificate nor refunded the money and the applicant filed a case after waiting for one year, the company was ordered to refund his money at 24% interest. *Vinod Krishna Khanna v. Neha Export Ltd.*, (2003) 42 SCL 22 (Delhi).

Limitation for taking cognizance.—Section 468 of the Criminal Procedure Code prescribes the period of six months for taking cognizance of an offence which is punishable with fine only. The offence under S. 113 is punishable with fine only and, therefore, it is necessary that a complaint must be filed within six months. Where a complaint was filed beyond the limitation period and no application was filed for condonation of delay, taking cognizance and issue of process by the magistrate was held to be not proper. The order of the sessions judge setting aside the order of the magistrate was held to be justified. *State of Maharashtra v. Raymond Woollen Mills Ltd.*, (2002) 111 Com Cases 847 (Bom).

Default made good.—Refund orders were sent to the two complaining share-applicants to whom shares could not be allotted. On a subsequent reconciliation of bank account it was found that refund orders were not encashed. The company sent demand drafts with interest up to date to the applicants. The court held that a complaint against the company for failure to refund application money within time was not maintainable. *Herdilia Unimers Ltd. v. Arun Bansal*, (1999) 96 Com Cases 521 (Raj). The prosecution launched by the applicants was quashed. In *PNB Mutual Fund v. M.S. Shoes East Ltd.*, (1998) 3 Comp LJ 346 (CLB—NB) the company was directed to make good the default in delivering debenture certificates and the matter was referred to SEBI for initiating appropriate penal proceedings.

Company undertaking to issue duplicates.—In response to the complaint of not receiving share certificates the company undertook to issue duplicates. On the matter of prosecution of officers in default the court found that there was no clear allegation against any manager or officer of the company. Merely because the accused persons were the directors of the accused company, they could not be charged with the default either under the Companies Act or under the Indian Penal Code, 1860. *Rameshchandra Manilal Kotla v. State of Gujarat*, (1998) 5 Comp LJ 217 (Guj) : (1998) 30 CLA 313.

Compoundable offence.—The offence is compoundable under section 621A.

Powers to make complaint for prosecution vest with SEBI [Sub-section (2)]

By virtue of the amendment made in section 621 by the Amendment Act, 2000, SEBI is statutorily vested with the power to file complaints as discussed earlier. Before the amendments in the section, 12 officers of the SEBI were authorised to file prosecution for offences under sub-section (2) of this section. [*Vide Notification No. 727(E) dt. 29-8-2000 under sec. 621*].

Sec. 621, as amended by the Amendment Act, 2000, empowers SEBI to authorise a person for filing of complaints under this section.

Remedy against default [Sub-section (3)]

Sub-section (3) provides a summary remedy of applying to the Company Law Board for an order directing the company and any officer thereof to issue the certificate in respect of which default has been committed. Note that if a person entitled to the certificate wants to apply to the CLB for an order directing the issue of the certificate, he must first serve a notice on the company as provided in sub-section (3), and only in the event of the company failing to comply with the notice within ten days, application to the CLB will lie. Such service of notice on the company is condition precedent to the making of the application.

The remedy under sub-section (3) is not available in case of disputed transfer of shares in, or debentures of, a company. The remedy in such cases lies under section 111 or section 111A.

Right to share certificate indefeasible.—The Company Law Board has held that the right to get share certificate within three months of allotment is an irrevocable right vested in every allottee of shares or debentures and is enforceable through an order of the CLB by virtue of section 113(3). This right cannot be taken away by any unilateral action on the part of the company. As such the company's attempt to withhold delivery of the certificate in respect of the bonus issue on the plea of outstanding dues to the company from the allottee was not valid and, therefore, not sustainable. The CLB further said that even if the company has the right of lien on shares reserved through its articles, it would not allow refusal to deliver a bonus or other issue certificates for every kind of debt due from the member. Lien is not enforcible by refusing to issue share certificates. The CLB has no power under section 113 to order payment of overdue dividend on shares or interest on debentures. *Trishla Jain (Smt.) v. Oswal Agro Mills Ltd.,* (1996) 86 Com Cases 48 (CLB—NB).

Right arises when share certificates are signed.—The moment share certificates are signed inside the office of the company, and name entered in the register, one of the external effects would be that the allottee or transferee becomes a shareholder, even if he has still not received his certificate. He gets the *locus standi* to move the Company Law Board for delivery of the certificate to him. *Herdilia Unimers Ltd. v. Renu Jain,* (1998) 92 Com Cases 841 (Raj).

CLB has no power to punish for default

While the Company Law Board can order the company to make good the default by delivering the certificate in question, it has no jurisdiction or power to punish the company or defaulting directors with fine. A complaint to bring about an order of fine or imprisonment can be made before a magistrate in accordance with the provisions of the Act. *Herdilia Unimers Ltd. v. Renu Jain,* (1998) 92 Com Cases 841 (Raj). Though the CLB has been given the power to extend the period of delivery of certificates, punishment for default, if any, would be in the domain of courts only. *Ghanshyam Chaturbhuj v. Industrial Ceramics P. Ltd.,* (1990) 68 Com Cases 36 (Mad). The jurisdiction of the Magistrate remained intact because the amendment of 1988 substituted Company Law Board only for the civil court. *Natvarlal A Jani v. N.N. Jain,* (1998) 29 CLA 415 : (1999) 98 Com Cases 720 (Guj) .

CLB has no power to compensate investor for delay in issuing certificates under s. 113

The section provides a statutory remedy for delivery of share certificates. There is no provision enabling the CLB to award compensation for business losses which have been caused by the delay. In this case, because of the delay in delivery, the shareholder was not able to sell his shares while the market was high. He wanted compensation for his loss. The CLB had no power in the matter. An order for costs can be made but in this case costs were not awarded because by the date of his application to the CLB the applicant had received the share certificates. For recovery of conpensation he would have to try his luck either at the doors of a Consumer Forum or those of a Civil Court. *Harish Kumar Agarwal v. Punjab Communications Ltd.,* (1998) 92 Com Cases 303 : (1998) 1 Comp LJ 347 : (1998) 28 CLA 249 (CLB—NB).

Delay in transfer of shares, issue of allotment letters/certificates, refund, *etc.*

Press Note, dated 11-1-1991.—The department has issued a *Press Note No.* 17/8/89-CL-V, dated 11-1-1991 on this subject. The text of the Press Note has been reproduced under section 111, *infra,* under the above head. Also see Notes under section 73, *ante.*

Jurisdiction for Investor Guidance, Grievances and Complaints

Delay in or non receipt of Share Certificate.—A complaint lies before the SEBI Forum. For the format of the complaint and addresses of the forum, see *Appendix* 234.

Petition before CLB

Petition for extending the period for delivery of the certificate of debentures under sub-section (1) has to be made by a company to the Regional Bench of the CLB in Form No. 1 of Annexture II to the CLB Regulations, 1991 with a fee of Rs. 500/- and accompanied by the following documents:

(1) Copy of the letter of allotment issued by the company.
(2) Copy of the instrument of transfer.
(3) Copies of the resolution of the Board allowing the transfer and/or seeking extension.
(4) Affidavit verifying the petition.
(5) Bank draft evidencing payment of application fee.
(6) Copy of the latest audited balance-sheet and profit and loss account together with auditor's report and directors' report.
(7) Memorandum of appearance in Form No. 5 of Annexure I with copy of the Board resolution or the executed Vakalatnama, as the case may be.

Petition under sub-section (3) for non-compliance of sub-section (1) prescribing time limit for issue of shares/debenture certificates be made by the person entitled thereto, with a fee of Rs. 50/- accompanied by the following documents:

(1) Copy of the letter of allotment issued by the company.
(2) Documentary evidence for the lodgement of shares or debentures for transfer, if any.
(3) Copy of the notice served on the company requiring it to make good the default in complying with the requirements of sub-section (1) of section 113.
(4) Any other correspondence.
(5) Affidavit verifying the petition.
(6) Bank draft evidencing payment of application fee.
(7) Memorandum of appearance in Form No. 5 of Annexure I with copy of the Board resolution or the executed Vakalatnama, as the case may be.

§ For text of the Company Law Board Regulations, 1991 refer *Appendix* 3.

ICSI Guidance Note on Compliance Certificate (August, 2003)

The ICSI has issued a Check List for issue of Compliance Certificate under proviso to Sec. 383A(1) in respect of the matters specified under Rule 3 of the Companies (Compliance Certificate) Rules, 2001. Paragraph 13(i) under Rule 3 relates to delivery of securities certificates and reads as follows:

Paragraph-13.—**The company has:**

(i) delivered all certificates on allotment of securities and on lodgement thereof for transfer/transmission or any other purpose in accordance with the provisions of the Act.

Prescribed Check List

Issue of Certificates for Shares and other Securities [*Item (a)*]

Check whether:

(i) the company has allotted shares/debentures and entered the names of allottees in its register of members/debentureholders;
(ii) the company has issued and delivered share-certificates as per sections 83 and 113 of the Act and the provisions of the Companies (Issue of Share Certificates) Rules, 1960;
(iii) the company has executed Debenture Trust Deed in case of secured debentures;

(iv) the company has delivered debenture-certificates within the prescribed period and in case of delay, CLB Order for extension of time has been obtained;

(v) the company has registered transfer and transmission of shares as per sections 108 to 113;

(vi) the company has kept in abeyance the registration of transfers in cases of Court-injunction.

§ For the text of the Companies (Compliance Certificate) Rules, 2001, see *Appendix* 38.

§ For the full text of the Guidance Notes on Compliance Certificate and for Specimen Compliance Certificate Form as issued by ICSI see *Appendix* 312.

Secretarial Practice Notes : Limitation for issue of certificates

(a) In case of allotment of shares/debentures check whether:

(i) the Board/Committee resolution passed to issue share certificates?

(ii) the share certificates were in the form and manner as required under the Companies (Issue of Share Certificates) Rules, 1960?

(iii) suitable entries made in the relevant Registers?

(iv) whether certificates posted within 3 months of allotment?

(b) In case of transfer, check whether:

(i) the Board/Committee resolution passed approving the transfer?

(ii) suitable entry made in the relevant registers?

(iii) certificates posted within 2 months of application therefor?

(c) If within the two or three months' period mentioned above, the certificates for debentures or debenture stock have not been delivered, whether an application has been made to CLB for extension of time?

Documents Involved: 1. Share/Debenture Certificates and Counterfoils, 2. Minutes of Board/Committee Meeting, 3. Application and Allotment Register, 4. Register of Duplicate Share Certificates, 5. Register of Members/Debenture-holders, 6. Transfer Register.

Relevant Rules and Forms

As regards issue of share certificates the Central Government has framed the Companies (Issue of Share Certificates) Rules, 1960. For text of the Rules see under section 84 *ante*.

Share Warrants

S. 114. Issue and effect of share warrants to bearer.—(1) A public company limited by shares, if so authorised by its articles, may, with the previous approval of the Central Government, with respect to any fully paid-up shares, issue under its common seal a warrant stating that the bearer of the warrant is entitled to the shares therein specified, and may provide, by coupons or otherwise, for the payment of the future dividends on the shares specified in the warrant.

(2) The warrant aforesaid is in this Act referred to as a "share warrant".

(3) A share warrant shall entitle the bearer thereof to the shares therein specified, and the shares may be transferred by delivery of the warrant.

NOTES

Eng. Act, 1948 : Sec. 83
Eng. Act, 1985 : Sec. 188

Previous Act : Secs. 43 to 48

Companies Act, 1956

Object and policy of section.—This section is based on the Indian Act of 1913 and English Act of 1985. The recommendations of the Company Law Committee, are reproduced below: "Sections 43 to 48 of the Indian Companies Act deal with 'share-warrants', we are not unaware of the ill deserved cover which share-warrants may provide for those who carry on anti-social activities, but we do not think that much use is made of these provisions in this country. We do not, therefore, consider it necessary to repeal these sections. The objects of public policy can, in our view, be adequately achieved by a stipulation to the effect that no such shares should be issued unless (a) there is a provision in the articles of the company for such issues, and (b) the prior approval of the Central Authority has been obtained". (Para 46).

Under the present, Act share warrants cannot be issued without the previous approval of the Central Government. But such approval was not required as per Regulation 35 of Table A of the First Schedule to the repealed Act of 1913. Even in cases where an existing company had adopted Table A of the First Schedule to the Act of 1913, though section 657(c) saves such adoption, the company must nevertheless apply for approval of the Central Government as "it only adds to and does not "affect" the adoption of the Regulations".

Issue of share warrants

The section gives permission to a public limited company with the approval of the Central Government to convert its fully paid-up shares into share warrants. They are issued under the common seal of the company. They certify that the bearer of the warrant is entitled to the shares specified in it bearing the serial number which should also be indicated on the warrants. The name of the shareholder to whom a warrant is issued is struck off the register of members. There should be a clear authority in the articles to issue warrants and preferably the rights of warrant holders should also be specified. The articles may provide that they shall continue to be the members for one or the other purposes: Payment of dividends may be taken care of by providing coupons or otherwise.

The section talks of only one category of warrants, *e.g.*, those payable to bearer. This is to enable an absolutely free circulation by transfer by simple delivery of the warrant. Such warrants become negotiable instruments. *Webb, Hale & Co. Alexandria Water Co. Ltd.*, (1905) 93 LT 339; *Stern v. R.*, (1896) 1 QB 211. Registration of the transfer with the company is not necessary.

The relevant articles of Table A relating to share warrants are Arts. 40 to 43.

SEBI Guidelines for Issue of Warrants and other Financial Instruments

Of late, many instances of issue of warrants and other financial instruments by companies before making initial public issue have come to our notice. These warrants are issued to existing shareholders/promoters and are exercisable at a later date, thus giving them a chance to acquire large chunks of shares at nominal prices (much lower than pricing in the public offer) without the necessity of seeking approval from the fraternity of public shareholders, as the warrants stand allotted prior to the entry of public shareholders into the company. Separate guidelines governing the issue of warrants and other financial instruments by listed companies to any select group of persons on a preferential basis have been issued by SEBI recently.

To protect the interests of the shareholders at large, who join the general body of the company at the time of public issue through the medium of initial public offer and in order to ensure that the prospectus brings out a clear picture of the paid-up capital of the

company, it has been decided that at the time of initial public offer by any company, there should not be any outstanding warrants or financial instruments of any other nature, which would give to the then existing promoters/shareholders, any right to acquire shares after the initial public offer. [*RMB (DIP Series) Circular No.* 4 (94-95), dated 30-8-1994].

This aspect is now incorporated in SEBI Guidelines, 2000 as indicated below :

Outstanding Warrants or Financial Instruments with option rights.—No unlisted company shall make a public issue of equity shares or any security convertible at later date into equity shares, if there are any outstanding financial instruments or any other right which would entitle the existing promoters or shareholders any option to receive equity share capital after the initial public offering [*Clause 2.6.1 of Chapter II*].

Private companies

A private company cannot issue any share warrants having regard to the provisions of section 114.

Reconversion of warrants into shares

The bearer of a share warrant may surrender it for cancellation to the company which must then register the bearer's name in its register of member in respect of shares specified in the warrant. The articles may place conditions on the surrender of warrants.

Stamp duty on share warrants

The stamp duty on share warrants to bearer is one and a half times the duty payable on a conveyance under Article 23 of the Stamp Act, to be calculated on a consideration equal to the nominal amount of the shares specified in the warrant. As the stamp duty on conveyance varies from State to State, it has to be calculated on the basis of duty for the time being in force in the State in which the share warrants are issued. Refer *Appendix* 138 for the Table of Stamps. Refer also K. KRISHNAMURTHY'S INDIAN STAMP ACT, 8th Edn., 2002.

Issue of share warrants outside India

Issue of share warrants to bearer outside India is not allowed, except under permission of the Reserve Bank of India.

Government policy on Issue of shares and securities to NRIs, foreigners and foreign companies

A number of Circulars and Press Notes have been issued by the Central Government and RBI under FERA. For Notes on this matter under FEMA, 1999, see under section 72 and *Appendix* 101.

Secretarial Practice Notes : Share warrants to bearer and entries in register

Whether share warrants issued by the company? If so, check whether:

(i) the issue was authorised by articles?
(ii) prior approval of the Central Government was obtained?
(iii) the shares were fully paid-up?
(iv) the warrant was issued under the common seal?
(v) due entries made in the register of members?
(vi) where necessary, the approval of the RBI was sought?

Documents Involved: 1. Share Warrants Register, if any, 2. Articles, 3. Approval of Central Government, 4. Register of Members, 5. Minutes of Board Meeting, 6. Approval of RBI.

S. 115. Share warrants and entries in register of members.—(1) On the issue of a share warrant, the company shall strike out of its register of members the name of the member then entered therein as holding the shares specified in the

warrant as if he had ceased to be a member, and shall enter in that register the following particulars, namely:—

(a) the fact of the issue of the warrant;

(b) a statement of the shares specified in the warrant, distinguishing each share by its number; and

(c) the date of the issue of the warrant.

(2) The bearer of a share warrant shall, subject to the articles of the company, be entitled on surrendering the warrant for cancellation and paying such fee to the company as the Board of Directors may from time to time determine, to have his name entered as a member in the register of members.

(3) The company shall be responsible for any loss incurred by any person by reason of the company entering in its register of members the name of a bearer of a share warrant in respect of the shares therein specified, without the warrant being surrendered and cancelled.

(4) Until the warrant is surrendered, the particulars specified in sub-section (1) shall be deemed to be the particulars required by this Act to be entered in the register of members; and, on the surrender, the date of the surrender shall be entered in that register.

(5) Subject to the provisions of this Act, the bearer of a share warrant may, if the articles of the company so provide, be deemed to be a member of the company within the meaning of this Act, for any purposes defined in the articles.

(6) If default is made in complying with any of the requirements of this section, the company, and every officer of the company who is in default, shall be punishable with fine which may extend to [1][*five hundred rupees*] for every day during which the default continues.

NOTES

Eng. Act, 1948 : Sec. 112
Eng. Act, 1985 : Sec. 355

Companies (Amendment) Act, 2000

Penalty enhanced.—The Amendment Act of 2000 enhanced the penalty amount from 50 rupees to 500 rupees under sub-section (6).

Warrant holder may be member [Sub-section (5)]

"Member" does not include the bearer of a share warrant [*vide* section 2(27)]. But for any purpose a company may, by its articles, provide that the bearer of a share warrant may exercise the rights of a member, such as attending meetings and appointing directors, approving annual accounts, *etc.*

Note that unless the articles of a company provide otherwise, the bearer of a share warrant is not entitled to any of the rights of membership. *Cf. S.D.N. Wadiyar v. Venkateswara Real Estate,* (1990) 68 Com Cases 216 (Kar).

Note further that having regard to the express provisions of section 270(4), the provisions of sub-section (5) of this section cannot enable the articles of a company to provide

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1. The words "fifty rupees" substituted by the Companies (Amendment) Act, 2000 (53 of 2000), s. 47 (w.e.f. 13-12-2000).

that the shares specified in a share warrant may be considered as qualification shares for the office of director.

Issue of share warrants and reduction of members below seven

Since under section 2(27) member does not include a bearer of share warrant, companies issuing share warrants should be cautious in not violating the provisions of section 45 under which reduction of the number of members below seven in the case of public companies would fasten the remaining members with personal liability. The articles may, therefore, provide that the holders of warrants shall be regarded as members for the purposes of s. 45.

Income-tax deduction at source

The holder of a share warrant is entitled to credit as regards tax deducted at source in the same way as a shareholder is entitled. See *CIT, Bombay v. Juliet M. Fateh,* (1979) 49 Com Cases 112 (Bom). In the Income-tax Act sections 194 and 199, the expression "shareholder" is not confined to registered shareholders alone and is wide enough to include holders of share warrants which are issued and held in the place of the shares specified in the warrants. However, companies issuing share warrants will have to face practical difficulties in the deduction of tax at source on dividends exceeding the prescribed amount.

§ See also Notes under S. 114, *ante.*

Penalty for default [Sub-section (6)]

On the issue of share warrants, a company is required to comply with the requirements of section 115. Any contravention of the provisions of this section attracts penalty for the company and every officer of the company who is in default of fine up to Rs. 500 for every day of default.

Compoundable Offence.—The offence is compoundable under section 621A.

Penalty for Personation of Shareholder

S. 116. Penalty for personation of shareholder.—If any person deceitfully personates an owner of any share or interest in a company, or of any share warrant or coupon issued in pursuance of this Act, and thereby obtains or attempts to obtain any such shares or interest or any such share warrant or coupon, or receives or attempts to receive any money due to any such owner, he shall be punishable with imprisonment for a term which may extend to three years and shall also be liable to fine.

NOTES

Eng. Act, 1984 : Sec. 84

Companies Act, 1956

Recommendation of Company Law Committee.—This section was adopted on the recommendation of the Company Law Committee as follows: "There is no provision in the Indian Companies Act, for penalising the false personation of a shareholder. Section 84 of the English Companies Act, 1948, which reproduces section 71 of the English Companies Act, 1929, imposes heavy penalty on any person, who falsely and deceitfully personates any owner of any share or interest in any company, and thereby obtains or endeavours to obtain any such share or interest or share-warrant or coupon or receives or endeavours to receive any money due to any such owner. We suggest that a similar provision should be inserted in the Indian Companies Act under this part of the Act." (*Report* : para 237).

Companies (Amendment) Act, 2000

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*]

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*].

Scope of Section

False personation of members in company meetings and fraudulent exercise of voting rights are not sought to be covered by this section.

For the meaning of cheating and cheating by personation, see sections 415 to 419 of the Indian Penal Code, 1860.

Company's duty of care in registering transfers

Two share certificates comprising of 100 shares each were sent to the company by a transferee for registration. The company returned him the certificate in his name for 100 shares and by mistake the other share certificate was sent to another member of the company having a similar name. The transferee's complaint was entertained by the Magistrate and notices were sent to the ghost recipient of the certificate and the Canara Bank to whom he had transferred the shares comprised in the certificate. The recipient was directed to be prosecuted under S. 116 for impersonation. The Canara Bank was directed to return the certificate. The company was directed to handover the certificate to the complainant after collecting it from the bank or to issue a duplicate if the bank was not able to return the original and also to compensate him with Rs. 500 and to take care to see that other incidental benefits, if any, accruing to the shares in the meantime, were handed over to the transferee-complainant. *BPL Sanyo Technologies Ltd. v. Rahul Agarwal,* (1995) 83 Com Cases 885 (Raj).

Another case of the same kind came before the Company Law Board in *Chambal Fertilisers and Chemicals Ltd. v. A. Venkata Reddy,* (1996) 86 Com Cases 145 (CLB—NR). The original allottee of the shares did not receive the certificate which must have been misdelivered or intercepted. He applied for and obtained duplicate certificate. In the meantime, the company discovered that the original had been lodged with the company under a transfer which was registered and the share certificate was issued to the transferee. The company applied to the Company Law Board for a decision as to who was the true owner. The Board directed the company to pay the price paid by the transferee in the market who was also registered as a member because he was the innocent victim of the fraud generated by the company's negligence and cancel the certificate issued to him and delete his name from the register of members and maintain the name of the original allottee.

In *R.S. Software (India) Ltd. v. G. Ravi,* (2002) 40 SCL 715 (CLB—Kol), the respondent informed the petitioner company about alleged loss of 12,000 shares. He claimed that he had lost the shares alongwith duly executed transfer deeds before lodgement of the transfer for registration. But the registered shareholders in respect of those shares claimed that they still had their original share certificates. The company filed a petition before the Company Law Board for direction to the police authority to investigate whether the respondent was purporting personation of *bona fide* shareholders, directions for protecting the interests of shareholders and issuance of notice to the respondent, order

of imprisonment of the respondent under S. 116 if his contention was found to be false. It was held that these prayers did not fall within the powers of the CLB under S. 111A.

Penalty for default

Deterrent punishment has been provided with compulsory imprisonment up to 3 years and fine without any limit.

Where a complaint disclosed an offence under the section and the person charged was not able to show any ground for quashing the complaint without trial, the court asked the Magistrate not to insist upon the personal appearance of the person concerned and allow appearance through counsel. *Anil D. Ambani v. Santosh Tyagi,* (2000) 1 Comp LJ 243 (Raj); *Dhirubhai H. Ambani v. Sonia Sethi,* (2001) 106 Com Cases 486 : (2001) 3 Comp LJ 75 (MP).

Compoundable offence.— The offence is not compoundable under section 621A.

Special Provisions as to Debentures[1]

S. 117. Debentures with voting rights not to be issued hereafter.—No company shall, after the commencement of this Act, issue any debentures carrying voting rights at any meeting of the company, whether generally or in respect of particular classes of business.

NOTES

Companies Act, 1956

Reason for not allowing debenture with voting rights.—This section gives effect to the following recommendations of the Company Law Committee : "Complaints were made to us that in some companies debentures were issued with voting rights, thereby placing the debentureholders in a much more advantageous position than the holders of equity. In view of the secured position of the former, under the usual terms of debenture trust-deeds, we consider it wrong in principle that their position should be further strengthened by giving them the right to vote on the same basis as the shareholders of the company. If debenture holders possess voting rights, they may be in a position to influence the policy of the company in a manner, which may be detrimental to the interests of the general body of shareholders. Apart from other abuses to which this practice is liable and on which we need not dilate in this context, we see no good reason for conferring voting rights on debentureholders. A suitable provision should, therefore, be made at an appropriate place in the Act prohibiting this practice." (*Report* : para 227).

The section only applies to debentures issued after the commencement of this Act. Voting rights as regards debentures existing on the date of such commencement are not affected.

Companies (Amendment) Act, 2000

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*]

1. For debentures, also see Chapter X of SEBI (DIP) Guidelines, 2000, see *Appendix* 162.

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*].

Debentures as method of raising loan capital

In addition to raising capital by means of shares, companies have frequently to go into the capital market for floating loans by issuing debentures. A debenture issue is therefore an equally important part of project financing along with share capital. A company can raise loans in various ways, *e.g.*, by an ordinary unsecured credit, by a mortgage on property, by making bills of exchange or promissory notes or by the issue of debentures. In all these cases one should first see whether the company has borrowing powers; secondly, whether the directors have authority to exercise that power without a resolution of the company; thirdly, whether there is any limit on the amount that may be borrowed and fourthly, whether the company or directors have powers to secure repayment by charging or by mortgaging the assets of the company.

In an Australian case the appellant company and others were parties to a trust deed executed as part of an arrangement whereby a number of public companies subscribed for cumulative redeemable preference shares in another company. Under the share issue agreement with each preference shareholder, the appellant company agreed to purchase the preference shares on the happening of certain contingent events, and this obligation was secured by charges on the land. It was held that the charge given by the appellant was security for its undertaking to buy the preference shares on certain contingencies and was not security for the performance of the company's obligations to redeem the shares issued. It was, therefore, not a mortgage in the true sense. The charge was not a debenture since this, in its ordinary sense, did not include a promise in writing by a company to purchase shares at a future date nor a specific mortgage of land to secure a future obligation to purchase property. *Handevel Pty Ltd. v. Comptroller of Stamps,* (1987) LRC (Comm) 754 at 765, 768 (High Court of Australia).

Borrowing on debentures

Debenture is the commonest method of borrowing by companies. A debenture is like a certificate of loan or a loan bond given under the seal of the company and evidencing the fact that the company is liable to pay specified amount with interest, usually charging the company's assets for repayment of the loan. They may be offered privately without issuing a prospectus, something which can also be done by the private company or they may be offered to the public by means of a prospectus, which, however, cannot be done by a private company.

The money raised by debentures becomes a part of the company's capital structure, but it does not become a share capital. It is a loan and therefore a debt due from the company and interest is payable whether there are profits or not. Although debentures are a well known instrument of loan in the mercantile world and quite a few provisions of the Companies Act deal with them, there is no complete definition of the term debenture. For an analysis of some of the attempted definitions, see Notes under Section 2(12), *ante.*

Debentures may be either a bare promise to pay the money or a promise secured by a mortgage or a charge. According to Section 124 the word charge includes a mortgage. A lender of money to a company must take care to see what kind of security he wants. He must also carefully see that the property covered by the charge is precisely described so that he can be sure of his security. It was pointed out in *Quset Cac Ltd., Re,* 1985 BCLC 266 that even a widely drafted charge covering 'all moneys' would not cover unsecured loan stock issued to a third party and subsequently acquired by the debenture-holder.

A bank to whom the company applied for loans on debentures, undertook investigation by its accountant into the borrowing company's financial position. It was held that the borrower was not liable for the costs of such investigation. *Gomba Holdings U.K. Ltd. v. Minories Finance Ltd. (No. 4),* (1994) 2 BCLC 435 (Ch D).

The mortgage or charge may be created by words to that effect in the debenture certificate itself or by a separate deed to the benefit of all the debenture-holders.

Debenture stock

§ For a discussion on the subject of debenture stock, see Notes under Sec. 2(12), *ante*.

Rate of stamp duty on debentures

Notification No. SO 130(E), dated 28-1-2004.—The Indian Stamp Act, 1899 has been amended (w.e.f. 1-3-2004). Article 27 deals with the rate of stamp duty :

Art. 27. Debenture (whether a mortgage debenture or not), being a marketable security transferable—				
(a) by endorsement or by a separate instrument of transfer—				
where the amount or value does not exceed Rs. 10;				Ten paise.
where it exceeds Rs. 10 and does not exceed Rs. 50;				Twenty paise.
Ditto	50	Ditto	100;	Thirty-five paise.
Ditto	100	Ditto	200;	Seventy-five paise.
Ditto	200	Ditto	300;	One rupee ten paise.
Ditto	300	Ditto	400;	One rupee fifty paise.
Ditto	400	Ditto	500;	One rupee eighty-five paise.
Ditto	500	Ditto	600;	Two-rupee twenty-five paise.
Ditto	600	Ditto	700;	Two rupee sixty paise.
Ditto	700	Ditto	800;	Three rupees.
Ditto	800	Ditto	900;	Three rupee forty paise.
Ditto	900	Ditto	1000;	Three rupee seventy-five paise
and for every Rs. 500 or part thereof in excess of Rs. 1,000;				One rupee eighty-five paise.
(b) by delivery—				
where the amount or value of the consideration for such debenture as set forth therein does not exceed Rs. 50;				Thirty-five paise.
where it exceeds Rs. 50 but does not exceed Rs. 100;				Seventy-five paise.
Ditto	100	Ditto	200;	One rupee fifty paise.
Ditto	200	Ditto	300;	Two rupees twenty-five paise.
Ditto	300	Ditto	400;	Three rupees.
Ditto	400	Ditto	500;	Three rupees seventy-five paise.
Ditto	500	Ditto	600;	Four rupees fifty paise
Ditto	600	Ditto	700;	Five rupees twenty-five paise.
Ditto	700	Ditto	800;	Six rupees.
Ditto	800	Ditto	900;	Six rupees seventy-five paise.
Ditto	900	Ditto	1000;	Seven rupees fifty paise.
and for every Rs. 500 or part thereof in excess of Rs. 1,000.				Three rupees seventy-five paise.

Explanation.—The term "Debenture" includes any interest coupons attached thereto but the amount of such coupons shall not be included in estimating the duty.

Exemption

A debenture issued by an incorporated company or other body corporate in terms of a registered mortgage-deed, duly stamped in respect of the full amount of debentures to be issued thereunder, whereby the company or body borrowing makes over, in whole or in part, their property to trustees for the benefit of the debenture holders;

Provided that the debentures so issued are expressed to be issued in terms of the said mortgage-deed.

The Rate of stamp duty varies from state to state. For the Schedule of stamp duty refer K. KRISHNAMURTHY – INDIAN STAMP ACT, 1899 (8th Edn.) 2002.

Interest on debentures

Interest is payable on debentures in accordance with the agreed terms and not otherwise. The debenture must therefore contain an agreement to pay interest. They should also provide that if the principal amount is not paid back at the due date, the interest shall

continue to be payable at the agreed rate. The interest on debentures is a debt. It is payable whether there are or are no profits, and, although such interest is usually to be charged against income account before arriving at the profit for the year, interest paid on capital borrowed for constructing works may during the period of construction properly be added to the capital and treated as part of the cost of construction. *Hinds v. Buenos Ayres Grand National Tramways,* (1906) 2 Ch 654. It has also been held that where interest on debentures has been paid out of capital, there being no profits, the company need not make good the capital expended before paying dividends. *Bosanquet v. St. John del Rey Mining Co.,* (1897) 77 LT 206; but see *Dovey v. Cory,* (1901) AC 477 (HL). Debentures usually provide that if default takes place in the payment of interest and continues upto a specified period, the principal shall become immediately payable. The debenture-holders may then recover judgments for principal and interest. *Re, European Central Railway,* (1876) 4 Ch D 33 (CA). Where interest is made payable only out of profits, the debentures are known as income bonds and all available profit has to be used towards this end untill the interest is paid in full. *Heslop v. Paraguay Central Rly. Co. Ltd.,* (1910) 54 Sol Jo 234. When a receiver is appointed the moneys available are applied, first in paying interest due, and the balance in repaying the capital, although, if the debenture-holders so require, they may have the moneys received applied in repaying capital in the first instance, which will be to their advantage if there is a deficiency, for these payments do not bear income-tax. Further, if the arrears of interest are not the same in all cases, each debenture-holder proves for the aggregate amount due to him for principal and interest. *Midland Express, Re,* (1914) 1 Ch 41 (CA).

Interest on call money

When the allottees of debentures were called upon to pay the call money by a certain date and the date was subsequently extended, it was held that the allotttees who had paid the amount according to the first date were entitled to interest from the date of payment up to the time of the extended date. The company had also agreed to pay 14% interest as ordered by the Court. The Court did not allow any claim for interest over the interest amount by reason of the provisions in s. 3 of the Interest Act, 1978. *M.G. Kapoor (Lt. Col.) v. UOI,* (2001) 103 Com Cases 924 (Del—DB).

Debentures to bearer

§ For a detailed study on debentures to bearer, see Notes under Section 2(12).

Transfer of registered debentures

§ For a study of this subject, see Notes under Sections 2(12), 108 to 112.

Issue of debentures at a discount

There is no restriction upon issue of debentures at a discount. The effect of a discount is that it amounts to an additional interest. *Webb v. Shropshire Rly. Co.,* (1893) 3 Ch 307 (CA). Commission can also be paid to underwriters and others for placing or guaranteeing to taking up of debenture. But convertible debentures cannot be issued at a discount because it would amount to a colourable scheme for issue of shares at a discount. This was laid down in *Moseley v. Koffyfontein Mines Ltd.,* (1904) 2 Ch 108 (CA) where debentures issued at a discount entitled the holder to convert them into shares of the same nominal amount as the debentures and they were also immediately convertible. The whole thing was held to be a devise by issuing shares at a discount. This decision left open the question whether an option to convert is valid if it is not exercisable until some time after the debentures are issued (*ibid* at 120). Where any commission, allowance or discount is paid or made in respect of debentures the total amount must be stated in the company's annual returns. A statement of the amount or rate of commission, discount or allowance must also be included in the particulars lodged with the Registrar for registering particulars of debentures under section 129, but failure to comply with this provision will not affect the validity of the debentures. The amount or rate paid or payable, during the preceding two years, as commission, will also need to be stated in every prospectus, to which Schedule II of the Act is applicable under section 56.

Convertible debentures

A convertible debenture means which by the terms of its issue gives the holder the right to exchange debenture wholly or in part with fully paid shares. The privilege of issuing convertible debentures had to be conceded to companies because even otherwise there was no reason why a company should not issue shares by the extinguishment of a debt. The only care which has to be taken is that convertible debentures may not be issued at a discount by way of a colourable scheme to issue shares at a discount. It is for this reason that particulars which have to be filed with the Registrar when there is payment for shares in kind have also to be filed when shares are issued in lieu of convertible debentures.

Where a bonus is payable on debentures only out of profits and there are no profits the bonus must not be satisfied by an issue of fully paid shares. *Famatina Development Corporation v. Bury,* (1910) AC 439 (HL). See also *Investment Trust Corporation v. Singapore Traction Company,* (1935) Ch 615.

For rules applicable to issue of convertible debentures by exercise of an option, see the Public Companies (Terms of Issue of Debentures and Raising of Loans with options to convert such Debentures or Loans into Shares) Rules, 1977 reproduced under the Notes on Section 81 *ante.*

Issue of shares on conversion of preference shares/convertible debentures

1. Where the conversion period is on or before a certain time, convene Board meeting to decide on the date of conversion and advise the stock exchanges where the instruments are listed or where the proposed issue of debenture is to be listed.

2. Where conversion price is linked to market price of the underlying equity shares, work out the conversion price on the basis of the pricing formula stated in the offer document.

3. Advise the preference shareholders/debenture-holders about the conversion price as worked out on the basis of the above formula.

4. Where the preference shares/convertible debentures are optionally convertible, obtain consent of the holders for the conversion.

5. Advise the stock exchanges about the record date fixed for the conversion so that trading in the convertible preference shares/debentures can stop before the said date.

6. Hold Board meeting and forfeit the preference shares/debentures which are partly paid after sending at least 3 notices, the last one by registered A/D.

7. Advise the stock exchanges about the shares/debentures forfeited.

8. Reissue the forfeited shares, if so decided by the Board and file return of allotment with ROC.

9. Process all transfers received till the record date for conversion.

10. Issue share certificates to the holders on conversion of the convertible preference shares/debentures into equity shares.

11. Where shares are issued in odd lots on conversion, organise the sale of odd lots by a Trust to be appointed and distribute the sale proceeds among the odd lot holders on *pro rata* basis by cheques/warrants.

12. File return of allotment with the ROC.

13. Arrange for listing of the shares on the stock exchanges.

14. Update the register of members.

Purchase/Sale of Shares and/or convertible debentures by an [1][NRI] on a stock exchange in India on repatriation and/or non-repatriation basis under portfolio investment scheme [Sch. 3]

1. A Non-resident Indian (NRI) [2][* * *] may purchase/sell shares and/or convertible debentures of an Indian company, through a registered broker on a recognised stock exchange, subject to the following conditions :

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1. Subs. by Amendment Regulations, *vide* Notfn. FEMA/46/2001-RB, dt. 29-11-2001.
2. Omitted by Amendment Regulations, *vide* Notfn. FEMA/46/2001-RB, dt. 29-11-2001.

[3][(i) NRIs may purchase and sell shares/convertible debentures under the Portfolio Investment Scheme through a branch designated by an Authorised Dealer for the purpose and duly approved by the Reserve Bank of India.];

(ii) the paid-up value of shares of an Indian company, purchased by each [4][NRI] both on repatriation and on non-repatriation basis, does not exceed 5 percent of the paid-up value of shares issued by the company concerned;

(iii) the paid-up value of each series of convertible debentures purchased by each [4][NRI] both on repatriation and non-repatriation basis does not exceed 5 percent of the paid-up value of each series of convertible debentures issued by the company concerned;

(iv) the aggregate paid-up value of shares of any company purchased by all [4][NRIs] does not exceed 10 percent of the paid up capital of the company and in the case of purchase of convertible debentures the aggregate paid-up value of each series of debentures purchased by all [4][NRIs] does not exceed 10 percent of the paid-up value of each series of convertible debentures;

Provided that the aggregate ceiling of 10 per cent referred to in this clause may be raised to 24 per cent if a special resolution to that effect is passed by the General Body of the Indian company concerned;

(v) the [4][NRI] investor takes delivery of the shares purchased and gives delivery of shares sold;

(vi) payment for purchase of shares and/or debentures is made by inward remittance in foreign exchange through normal banking channels or out of funds held in NRE/FCNR account maintained in India if the shares are purchased on repatriation basis and by inward remittance or out of funds held in NRE/FCNR/ NRO/NRNR/NRSR account of the [4][NRI] concerned maintained in India where the shares/debentures are purchased on non-repatriation basis;

(vi) [5][* * * * *]

2. Report to Reserve Bank

[4][The link office of the designated branch of an authorised dealer referred to in paragraph 1, shall furnish to the Chief General Manager, RBI, ECD, Central Office, Mumbai, a report on daily basis on PIS transactions undertaken by it, such report to be furnished on line or on floppy or in hard copy in a format supplied by the Reserve Bank.]

[6]**[3. Remittance/credit of sale/maturity proceeds of shares and/or debentures**

*The net sale/maturity proceeds (after payment of taxes) of shares and/or debentures of an Indian company purchased by NRI [7][* * *] under this scheme, may be allowed by the designated branch of an authorised dealer referred to in paragraph 1—,*

*(a) to be credited to NRO account of the NRI [8][* * *] investor where the payment for purchase of shares and/or debentures sold was made out of funds held in NRO account or where the shares and/or debentures were purchased on non-repatriation basis, or*

*(b) at the NRI [7][* * *] investor's option, to be remitted abroad or credited to his/its NRE/FCNR/NRO account of the NRI, where shares and/or debentures were purchased on repatriation basis.]"*

Remittance of Interest to NRIs/OCBs under FEMA, 1999

The income or interest earned on investments in Indian companies on non-repatriation basis shall be credited to the NRO Account of the NRI/OCB, in terms of Schedule 7 of

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3. Subs. by Second Amendment Regulations, 2003, *vide* Notfn. GSR 558(E), dt. 18-6-2003.
4. Subs. by Amendment Regulations, 2001 *vide* FEMA/46/2001-RB, dt. 29-11-2001.
5. Omitted by Amendment Regulations, 2001 *vide* FEMA/46/2001, dt. 29-11-2001.
6. Subs. by Second Amendment Regulations, 2003, *vide* Notfn. GSR 558(E), dt. 18-6-2003.
7. The words "or OCB" omitted by FEMA 101/2003-RB, dt. 3-10-2003.
8. The words "/OCB" omitted by FEMA 101/2003-RB, dt. 3-10-2003.

FEM (Deposit) Regulations, 2000 and the same can be remitted (being current year's income) through NRO Account, as per Schedule 3 thereto.

§ See also Notes under section 205.

§ For text of the Regulations, see *Appendix* 110.

SEBI GUIDELINES, 2000 FOR ISSUE OF CONVERTIBLE AND NON-CONVERTIBLE DEBENTURES

"Debt-Instrument" means an instrument which creates or acknowledges indebtedness, and includes debenture, stock, bonds and such other securities of a body corporate, whether constituting a charge on the assets of the body corporate or not [*Clause 1.2.1(xi)*].

A company offering convertible/non-convertible debt instruments through an offer document, shall comply with the following provisions in addition to the relevant provisions contained in other Chapters of SEBI Guidelines 2000 [*Clause 10.0*].

Eligibility

Outstanding Warrants or Financial Instruments.—No unlisted company shall make a public issue of any security convertible at later date into equity share, if there are any outstanding financial instruments or any other right which would entitle the existing promoters or shareholders any option to receive equity share capital after the initial public offering [*Clause 2.6.1*].

Partly Paid-up Shares.—No company shall make a public or rights issue of any security convertible at later date into equity share, unless all the existing partly paid-up shares have been fully paid or forfeited [*Clause 2.7.1*].

Object of issue.—A company is prohibited from issuing debentures for acquisition of shares of, or providing loan to, any company belonging to the same group. However, fully convertible debentures providing for conversion within 18 months can be made [*Clause 10.8.3*].

Debenture issues by companies belonging to the groups for financing replenishing funds or acquiring share holding in other companies shall not be permitted.

Explanation :

The expression 'replenishing of funds or acquiring shares in other companies' shall mean replenishment of funds or acquiring share holdings of other companies in the same group. In other words, the company shall not issue debentures for acquisition of shares/providing loan to any company belonging to the same group. However, the company may issue equity shares for purposes of repayment of loan to or investment in companies belonging to the same group. [*Clause 10.2.6(d)*].

Requirement of credit rating

No company shall make a public issue or rights issue of debt instruments (whether convertible or not), unless credit rating of not less than investment grade is obtained from not less than two registered credit rating agencies and disclosed in the offer document. [*Clauses 10.1.1* and *6.3.12(a)*]. [*Subs. by SEBI Circular No. 11, dt. 14-8-2003*].

This condition is to be satisfied as on the date of filing of the draft offer document with SEBI as also on the date of the filing of the final offer document with ROC/Designated Stock Exchange [*See Clause 2.5.1A(i)* as subs. *Ibid.*].

Where credit ratings are obtained from more than two credit rating agencies, all the credit ratings, including the unaccepted credit ratings, shall be disclosed. [*Clauses 10.1.3 and 6.3.12(b)*] [*Subs. Ibid.*].

All the credit ratings obtained during the three (3) years preceding the public or rights issue of debt instrument (including convertible instruments) for any listed security of the issuer company shall be disclosed in the offer document [*Clauses 2.5.4, 6.3.12(c) and 10.1.4*].

Company free to determine premium, period of conversion and interest

Premium amount and time of conversion shall be determined by the issuer company and disclosed. [*Clause 10.8.4*].

The interest rate for debentures can be freely determined by the issuer company. [*Clause 10.8.5*].

Additional conditions

No company shall make a public issue or rights issue of debt instruments (whether convertible or not), unless the following conditions are also satisfied, as on date of filing of draft offer document with SEBI and also on the date of filing a final offer document with ROC/Designated Stock Exchange.

The company is not in the list of willful defaulters of RBI.

The company is not in default of payment of interest or repayment of principal in respect of debentures issued to the public, if any, for a period of more than 6 months. [*Clause 2.5.1A(ii) and (iii)*] [*Subs. by SEBI Circular No. 11, dt. 14-8-2003*].

Minimum number of allottes of non-convertible debt instruments shall be fifty

An issuer company shall not make an allotment of non-convertible debt instrument pursuant to public issue if the proposed allottees are less than fifty (50) in number. In such a case the company shall forthwith refund the entire subscription amount received. If there is a delay beyond 8 days after the company becomes liable to pay the amount, the company shall pay interest @ 15% p.a. to the investors. [*Clauses 2.5.1B*] [*Subs. by SEBI Circular No. 11, dt. 14-8-2003*].

Appointment of Debenture Trustee

No company shall issue a prospectus or a letter of offer to the public for subscription of its debentures, unless the company has appointed one or more debenture trustees for such debentures in accordance with the provisions of the Companies Act, 1956. [*Clause 10.2.1.*] [*Subs. Ibid*].

The names of the debenture trustees shall be stated in the offer documents and also in all the subsequent periodical communications sent to the debenture holders. [*Clause 10.2.2.*] [Subs. *Ibid.*]

Execution of trust deed

A trust deed shall be executed by the issuer company in favour of the debenture trustees within three months of the closure of the issue [*Clause 10.2.3*]. [Subs. *Ibid*].

Fresh trust deed should be executed at the time of roll over of PCDs/NCDs [*Clause 10.7.1.1(d)*].

Redemption

The issuer company shall redeem the debentures as per the offer document [*Clause 10.5.1*].

Distribution of Dividends

(a) In case of the companies which have defaulted in payment of interest on debentures or redeption of debentures or in creation of security as per the terms of issue of the debentures, any distribution of dividend shall require approval of the Debenture Trustees and the Lead Institution, if any [*Subs. by SEBI Circular No. 11, dt. 14-8-2003*].

(b) In the case of existing companies prior permission of the lead institution for declaring dividend exceeding 20% or as per the loan covenants is necessary if the company does not comply with institutional condition regarding interest and debt service coverage ratio.

(c) (i) Dividends may be distributed out of profit of particular years only after transfer of requisite amount in DRR.

(ii) If residual profits after transfer to DRR are inadequate to distribute reasonable dividends, company may distribute dividend out of general reserve [*Clause 10.4*].

Requirement of letter of option

Conversion option.—No company shall issue of FCDs having a conversion period of more than 36 months, unless conversion is made optional with "put" and "call" option [*Clause 10.8.1*].

If the conversion takes place at or after 18 months from the date of allotment, but before 36 months, any conversion in part or whole of the debenture shall be optional at the hands of the debenture holder [*Clause 10.8.2*].

Filing of letter of option

"10.7.1 Where the company desires to rollover the debentures issued by it, it shall file with SEBI a copy of the notice of the resolution to be sent to the debenture-holders for the purpose, through a merchant banker prior to dispatching the same to the debenture-holders. The notice shall contain disclosures with regard to credit rating, necessity for debenture-holders resolution and such other terms which SEBI may specify. Where the company desires to convert the debentures into equity shares in accordance with clause 10.7.2, it shall file with SEBI a copy of the letter of option to be sent to debenture-holders with the Board, through a merchant banker, prior to dispatching the same to the debenture-holders. The letter of option shall contain disclosures with regard to option for conversion, justification for conversion price and such other terms which SEBI may specify. [*Clause 10.7.1*] [*Subs. by SEBI Circular No. 11, dt. 14-8-2003*].

Roll over of NCDs/PCDs

By company not being in default.—The non-convertible portions of PCDs or the NCDs issued by a listed company, the value of which exceeds Rs.50 lacs, can be rolled over without change in the interest rate subject to section 121 of the Companies Act, 1956 and subject to the following conditions, if the company is not in default:

(a) A resolution to this effect is passed by postal ballot, having the assent from not less than 75% of the debenture-holders.

(b) The company shall redeem the debentures of all the dissenting debenture holders, who have not assented to the resolution.

(c) Before roll over of any NCDs or non-convertible portion of the PCDs, at least two credit ratings of not less than investment grade, shall be obtained within a period of six months prior to the due date of redemption and communicated to debenture holders before roll over:

(d) Fresh trust deed shall be executed at the time of such roll over.

(e) Fresh security shall be created in respect of such debentures to be rolled over.

Provided that if the existing trust deed or the security documents provide for continuance of the security till redemption of debentures, fresh trust deed or fresh security need not be created. [*Clause 10.7.1.1.*] [Subs. *Ibid*].

By the company being in default.—The non-convertible portions of PCDs and the NCDs issued by a listed company, the value of which exceeds Rs.50 lacs, can be rolled over without change in the interest rate subject to section 121 of the Companies Act, 1956 and subject to the following conditions, where the company is in default:

(a) A resolution to this effect is passed by postal ballot, having the assent from not less than 75% of the debenture-holders.

(b) The company shall send an Auditors' certificate on the cash flow of the company with comments on the liquidity position of the company to all debenture holders, along with the notice for passing the said resolution.

(c) The company shall redeem the debentures of all the dissenting debenture holders, who have not assented to the resolution.

(d) The debenture trustee shall decide on whether the company is required to create fresh security and execute fresh trust deed in respect of such debentures to be rolled over :

Provided that if the existing trust deed or the security documents provide for continuance of the security till redemption of debentures, fresh security and fresh trust deed need not be created. [Inserted *Ibid*].

Conversion of PCDs/FCDs

In case of conversion of instruments (PCDs/FCDs, *etc.*) into equity capital

(i) In case, the convertible portion of any instrument such as PCDs, FCDs *etc.* issued by a listed company, value of which exceeds Rs.50 lacs and whose conversion price was not fixed at the time of issue, holders of such instruments shall be given a compulsory option of not converting into equity capital.

(ii) Conversion shall be done only in cases where instrument holders have sent their positive consent and not on the basis of the non-receipt of their negative reply:

Provided that where issues are made and cap price with justification thereon, is fixed beforehand in respect of any instruments by the issuer and disclosed to the investors before issue, it will not be necessary to give option to the instrument holder for converting the instruments into equity capital within the cap price.

(iii) In cases where an option is to be given to such instrument holders and if any instrument holder does not exercise the option to convert the debentures into equity at a price determined in the general meeting of the shareholders, the company shall redeem that part of debenture at a price which shall not be less than its face value, within one month from the last date by which option is to be exercised.

(iv) The provision of sub-clause (iii) above shall not apply if such redemption is to be made in accordance with the terms of the issue originally stated [*Clause 10.7.1.2*].

Issue of unsecured/subordinated debt instruments

Companies may issue unsecured/subordinated debt instruments/obligations (which are not 'public deposits' as per the provisions of section 58A of the Companies Act, 1956 or such other notifications, guidelines, circular, etc., issued by RBI, DCA or other authorities):

Provided that such issue shall be subscribed by qualified institutional buyers or other investor who has given positive consent for subscribing to such unsecured/subordinated debt instruments/obligation. [*Cl. 10.7.2*].

Additional Disclosures in respect of debentures

As mentioned above, details of credit rating, names of debenture trustees, proposal to create or not to create charge in respect of debentures of maturity of less than 18 months and implications thereof are to be disclosed in the offer document.

The offer document shall also contain:—

(a) Premium amount on conversion, time of conversion.

(b) In case of PCDs/NCDs, redemption amount, period of maturity, yield on redemption of the PCDs/NCDs.

(c) Full information relating to the terms of offer or purchase including the name(s) of the party offering to purchase the khokhas (non-convertible portion of PCDs).

(d) The discount at which such offer is made and the effective price for the investor as a result of such discount.

(e) The existing and future equity and long term debt ratio.

(f) Servicing behaviour on existing debentures, payment of due interest on due dates on term loans and debentures.

(g) That the certificate from a financial institution or bankers about their no objection for a second or *pari passu* charge being created in favour of the trustees to the proposed debenture issues has been obtained [*Clause 10.9*].

Disclosure of company's undertaking.—In case of a debenture issue, the company shall also give undertakings to the following effect in the offer document:

(i) That the company shall forward the details of utilization of the funds raised through the debentures duly certified by the statutory auditors of the company, to the debenture trustees at the end of each half-year.

(ii) That the company shall disclose the complete name and address of the debenture trustee in the annual report.

(iii) That the company shall provide a compliance certificate to the debenture holders (on yearly basis) in respect of compliance with the terms and conditions of issue of debentures as contained in the offer document, duly certified by the debenture trustee.

(iv) That the company shall furnish a confirmation certificate that the security created by the company in favour of the debenture holders is properly maintained and is adequate enough to meet the payment obligations towards the debenture holders in the event of default. [*Clause 6.5.6.2*] [*Ins. by SEBI Circular No. 11, dt. 14-8-2003*].

Issue of Debentures Bearing Interest Less Than Bank Rate

Whenever FCDs are issued bearing interest at a rate less than the Bank Rate, the offer document shall contain disclosures about the price that would work out to the investor, taking into account the notional interest loss on the investment from the date of allotment of FCDs to the date(s) of conversions. [*Clause 8.16.1*].

Computation of Promoters Contribution in Case of Issue of Convertible Security

In case of any issue of convertible security by a company, the promoters shall have an option to bring in their subscription by way of equity or by way of subscription to the convertible security being offered through the proposed issue so that the total promoters contribution shall not be less than the required minimum contribution referred to in clauses 4.1.1, 4.2.1, 4.3.1 4.4.1 of Chapter IV of SEBI (DIP) Guidelines, 2000.

Provided that, if the conversion price of emerging equity is not pre-determined and the same has not been specified in the offer document (instead a formula for conversion price is indicated), the promoters shall not have the said option and shall contribute by subscribing to the same instrument. [*Clause 4.7.1*]

In case of any issue of security convertible in stages either at par or premium (conversion price being predetermined), the promoters contribution in terms of equity share capital shall not be at a price lower than the weighted average price of the share capital arising out of conversion.

Explanation:

(a) 'weights' means the number of equity shares arising out of conversion of security into equity at various stages;

(b) 'price' means the price of equity shares on conversion arrived at after taking into account predetermined conversion price at various stages. [*Clause 4.7.2*]

The promoters contribution shall be computed on the basis of post-issue capital assuming full proposed conversion of such convertible security into equity:

Provided that where the promoter is contributing through the same optional convertible security as is being offered to the public, such contribution shall be eligible as promoters contribution only if the promoter(s) undertakes in writing to accept full conversion. [*Clause 4.7.3*].

Restriction on further capital issues

No company shall, pending conversion of Fully Convertible Debentures (FCDs) or Partly Convertible Debentures (PCDs), issue any shares by way of bonus or rights unless similar benefit is extended to the holders of such FCDs or PCDs, through reservation of shares in proportion to such convertible part of FCDs/PCDs [*Clause 8.7.2(a)*].

Shares so reserved may be issued at the time of conversion(s) of such debentures on the same terms on which the bonus or rights issue was made [*Clause 8.7.2(b)*].

Purchase of Non-Convertible part of debentures from the subscribers

SEBI's Circular No. CIR/UCD/26-1148/91, dated 4-11-1991.—It has been observed that a number of companies are advising privately to the prospective investors simultaneously with the public issue of prospectus or the letter of offer of rights that some arrangements are being made with a bank for purchase of non-convertible portion (*khokhas*) of the debentures. Further, such information is passed on to the investors before the close of the subscription list. Besides, the information so made available to the investors is either insufficient or barely adequate to facilitate any rational investment decision.

2. In the above context, we invite your attention to clause (ix) of the Code of Conduct for merchant bankers, whereby a merchant banker is obliged to ensure that true and adequate information is provided to the investors; no misguiding or exaggerated claims or statements are made, and the investors are made aware of the attendant risks before they take any investment decision. Despite this requirement, it is observed that incomplete information regarding purchase of *khokhas* without disclosing the material terms of the proposal are allowed to be passed on to the investors. Furthermore, it is observed that such information is made available to the investors after the announcement of an issue, even though the material terms are not firmed up. This practice can be construed as being intended to induce the investors to invest in the issue on the basis of incomplete information. It is therefore desirable that this practice is discontinued in the larger interest of the investors. If at all any terms of offer are firmed up at this stage, the same should be incorporated in the prospectus or the letter of offer or in any subsequent communication to the investors. This will enable the investors to take a well informed decision on the proposed investment.

3. In addition, any proposal that may be agreed upon between the company and a bank or any person for purchase of *khokhas*, should be in conformity with the provisions of sections 13 and 18 of the Securities Contracts (Regulation) Act, 1956. The merchant bankers are aware that in the notified areas the transactions in securities can be entered into only through members of a recognised stock exchange. However, this restriction does not apply to spot delivery contracts which envisage actual delivery of securities and the payment of their price on the *same day or the next day* subject to exclusion of the actual period taken for despatch of securities or the remittance of moneys therefor through the post if the parties to the contract do not reside in the same town or locality. Therefore, any proposal for purchase of *khokhas* must necessarily provide for payment simultaneously with or in any case, not later than the period mentioned above after the delivery of *khokha* scrips or the *khokha* portion of the letters of allotment. Consequently, the present widespread practice of delaying payments to the investors after the delivery of *khokha* scrips on grounds like verification of the signature of the seller, etc. should be discontinued; nor can the contract be revoked on that ground. Since purchase of *Khokhas* is no different from the purchase of securities in the market, and the risk arising out of non-verification of seller's signature and consequent bad delivery is minimal, the risk, if any, in the transaction should be borne by the purchaser.

4. In view of the above, the merchant bankers are advised to ensure that—

(*i*) the investors are not given any information through personal communication or advertisement either by the company or by any other person which is not provided in the prospectus or the letter of offer about the proposed arrangements for purchase of *khokha*) if any such arrangement has been made, the same is incorporated with material particulars including purchase price in the prospectus, the letter of offer or any subsequent communication to the investors; and

(*ii*) such offer of purcahse of *khokhas* is consistent with the provisions of the Securities Contracts (Regulation) Act, 1956 and in particular, the terms of offer specifically provide for payment simultaneously with, or in any case, not later than the period specified in section 2(i) of the said Act, after the delivery of *khokha* scrips or the *khokha* portion of the letters of allotment.

If for any reason, the criteria laid down at (i) and (ii) above are not fulfilled, the circulation of any offer for purchase of *khokhas* should not be permitted at least during the period the merchant banker is associated with the issue. Needless to say the merchant bankers should preferably obtain an undertaking from the issuers for compliance of this requirement as long as the issue is open. Even thereafter the banks or any other person who may offer to purchase *khokhas* should comply with the requirements of the Securities Contracts (Regulation) Act.

Private placement of debt securities by listed companies

Secondary Market for Corporate Debt Securities

SEBI Circular No. SEBI/MRD/SE/AT/36/2003/30/09, September 30, 2003, issued to Stock Exchanges.—1. Companies have been issuing debt securities on private placement basis from time to time. In order to provide greater transparency to such issuances and to protect the interest of investors in such securities, it has been decided that any listed company making issue of debt securities on a private placement basis and listed on a stock exchange shall be required to comply with the following:-

1.1. The company shall make full disclosures (initial and continuing) in the manner prescribed in Schedule II of the Companies Act, 1956, SEBI (Disclosure and Investor Protection) Guidelines, 2000 and the Listing Agreement with the exchanges. However, if the privately placed debt securities are in standard denomination of Rs.10 Lakhs, such disclosures may be made only through web sites of the stock exchange where the debt securities are sought to be listed.

1.2. The debt securities shall carry a credit rating of not less than investment grade from a Credit Rating Agency registered with the Board.

1.3. The company shall appoint a debenture trustee registered with SEBI in respect of the issue of the debt securities.

1.4. The debt securities shall be issued and traded in demat form.

1.5. The company shall sign a separate listing agreement with the exchange in respect of debt securities and comply with the conditions of listing.

1.6. All trades with the exception of spot transactions, in a listed debt security, shall be executed only on the trading platform of a stock exchange.

1.7. The trading in privately placed debts shall only take place between Qualified Institutional Investors (QIBs) and High Networth Individuals (HNIs), in standard denomination of Rs.10 lakhs.

1.8. The requirement of Rule 19(2)(b) of the Securities Contract (Regulation) Rules, 1957 will not be applicable to listing of privately placed debt securities on exchanges, provided all the above requirements are complied with.

1.9. If the intermediaries registered with SEBI associate themselves with the issuance of private placement of unlisted debt securities, they will be held accountable for such issues. They will also be required to furnish periodical reports to SEBI in such format as may be decided by SEBI.

2. The stock exchanges are directed to:

2.1 make necessary amendments to the listing agreement, bye-laws, rules and regulations for the implementation of the above decision immediately, as may be applicable.

2.2 bring the provisions of this circular to the notice of the listed companies/member brokers/clearing members of the Exchange and also to disseminate the same on the website for easy access to the investors; and

2.3 communicate to SEBI, the status of the implementation of the provisions of this circular in Section II, item no. 13 of the Monthly Development Report for the month of October 2003.

RBI GUIDELINES ON INVESTMENTS BY THE SELECT ALL-INDIA FIs IN NON-GOVERNMENT DEBT-SECURITIES, DBS.FID.No. C-8/01.02.00/2003-04, dated 4-11-2003

The matter of regulating resource raising by the listed companies through private placement of debt had been under consideration of SEBI. SEBI has since issued a Circular (No. SEBI/MRD/SE/AT/36/2003/30/9 dated 30-9-2003 prescribing the guidelines to be complied with by the listed companies issuing debt securities through private placement.

2. Since the financial institutions ('Fis') too acquire debt instruments issued by corporate entities, from the primary as well as secondary market, guidelines have been drafted and are proposed to be issued to the FIs by the Reserve Bank of India ('RBI'). The guidelines seek to address the risks arising from investment in non-government debt securities, particularly through private placement, and, *inter alia*, cover the following aspects:

(a) the need for strengthening the internal rating systems of the FIs;

(b) prudential limits on the exposure through debt securities;

(c) review by the Board of Directors of the FIs; and

(d) public disclosures in the 'Notes on Accounts' to the balance sheet.

These guidelines apply to the FIs' investments, both in the primary market (public issue as also private placement) as well as the secondary market, in debt instruments issued by companies, banks, FIs and State and Central Government sponsored institutions, SPVs, etc., but do not apply to government securities and securities which are in the nature of advance under the extant prudential norms of RBI.

§ For text of RBI Guidelines, see *Appendix* 165.

Listing of NCDs and DSCEs issued to the public by unlisted company

SEBI (DIP) Guidelines, 2000 [*clause 8.2*] lays dwon the conditions subject to which an unlisted company making public issue of non-convertible debt securities (NCDs) and debt securities convertible into equity after allotment (DSCE) can get the NCDs and DSCEs listed on a stock exchange without making prior public issue of equity.

§ See Notes under section 73.

Credit Rating Agencies in India.—The following are the agencies carrying out the services of credit rating:

1. Credit Analysis and Research Ltd. (CARE).

2. Investment Information and Credit Rating Agency of India Ltd. (ICRA).

3. Credit Rating Information Services of India Ltd. (CRISIL).

4. FITCH Credit Ratings India Pvt. Ltd.

5. Moody's Investor Services ("Moody's")

6. Standard and Poor's Corporation ("S&P")

§ For the details of the agencies and their working see *Appendix* 267.

SEBI (Credit Rating Agencies) Regulations, 1999

SEBI has issued Regulations for Credit Rating Agencies *vide* Notification No S.O. 547(E), dt. 7-7-1999.

§ For the text of the Regulations, 1999 see *Appendix* 205.

Disclosures in Debentures with warrants etc.

SEBI Guidelines, 2000.—The lead manager shall ensure adequate disclosures in the offer document, more particularly relating to the terms and conditions, redemption, security, conversion and any other relevant features of any new financial instruments such as Deep Discount Bonds, Debentures with Warrants, Secured Premium Notes *etc.* [*Clause 8.15.1 of Chapter VIII*].

Remedies of debenture-holder

A debenture-holder who wishes to realise his security and get his money back, may either exercise remedies given by the debenture trust deed without recourse to the court or take proceedings to enforce his rights. Where a debenture is repayable on demand, it is required of the lender that he should give the borrower a reasonable opportunity to collect the money owed. It is not necessary to allow time to permit the borrowing company to engage in commercial transactions for the purpose of raising the money. *Lloyds Bank plc. v. Lampert* (1999) BCC 507. The remedies which may be available are as follows—

Sale of charged property.—If the debenture-holder is the holder of a single debenture giving a charge on assets of the company, he will usually have an express power of sale or the implied power of sale given to mortgagees by the Transfer of Property Act, 1882, Section 67.

This arises if the conditions of Section 69 of T.P. Act are satisfied and either—

(i) notice requiring repayment has been served and default has been made for three months; or

(ii) some interest (minimum of Rs. 500.00) is in arrear for three months after becoming due; or

(iii) there has been a breach of some term of the debenture other than one for payment of capital or interest.

If there is a trust deed, the trustees will normally have an express or implied power of sale out of court over the fixed assets. Sale may also be claimed in a debenture-holders' action.

The holder of one of a series of debentures cannot sell the property charged, unless the debentures contain an express power of sale. *Blaker v. Herts and Essex Waterworks Co.*, (1889) 41 Ch D 399.

A pledgee has a right to sell pledged property if the obligation secured by the pledge is not met. *Richardson, Re,* (1885) 30 Ch D 396 (CA); *Hardwick, Re,* (1886) 17 QBD 690 (CA); *Morritt, Re,* (1886) 18 QBD 222 (CA).

A legal mortgagee of stocks and shares traded on the Stock Exchange has a right to sell them when the obligation secured by the mortgage is not met. *Wilson v. Tooker,* (1714) 5 Bro Parl Cas 193 HL : 2 ER 622; *Deverges v. Sandeman Clark & Co.,* (1902) 1 Ch 579 (CA).

Any profit made on selling charged property, after the secured obligation is met, is held on trust for the surety (Law of Property Act, 1925, s. 105) [English].

Duty to realise true market value.—When exercising a power of sale over charged property a chargee cannot sell to himself, either as a sole purchaser or jointly with others; and he cannot sell to a trustee for himself *Downes v. Grazebrook,* (1817) 3 Mer 200, though he can sell to a company in which he is interested. *Tse Kwong Lam v. Wong Chit Sen.* (1983) 1 WLR 1349 (PC). While exercising a power of sale of charged property a

chargee has a duty to take reasonable care to obtain the true market value of the property, *Cuckmere Brick Co. Ltd. v. Mutual Finance Ltd.*, (1971) Ch 949 (CA). However, a chargee is entitled to sell when his power of sale becomes exercisable (*i.e.*, when the secured obligation is due and has not been paid). If the market happens to be depressed at that time, he is under no obligation to wait until it improves *Bank of Cyprus (London) Ltd. v. Gill*, (1980) 2 Lloyd's Rep 51 (CA). Liability for breach of this duty may be excluded by an appropriately worded provision of the charge contract, *Bishop v. Bonham*, 1988 BCLC 656 (CA), in which the wording of the contract was not effective to exclude the liability.

On default by the company to pay back the money due under the charge, the chargee appointed a receiver and the company's business was sold to an associated company of the chargee. The plaintiff was the principal shareholder and an employee of the company. He had borrowed another sum of money from a bank by a second charge on the company's assets for which he had given a personal guarantee. He contended that the sale was at an under value and he had a right to hold the chargee and the receiver liable for his losses. The court agreed with him to this extent that equity recognises duties of good faith and of care on the part of a mortgagee and a receiver appointed by him to the mortgagor and others interested in the equity of redemption including any guarantor of the secured indebtedness. If the mortgagee realised less value, then a person interested in the equity of redemption can require the mortgagee to make good the loss in value of the equity of redemption or to provide compensation for the same. The plaintiff could not exercise this right because he had made no payment to the bank under his guarantee and the liability to the bank was also statute-barred and there was no evidence that the sale of the company's business at a proper value would have left a surplus after discharging the first charge. *Burgess v. Auger*, (1998) 2 BCLC 478; *Burgess v. Vanstock Ltd.*, (1998) 2 BCLC 478 (Ch. D).

Where the property was brought to sale by the creditor bank through its receiver, the court said : On the facts, taking into account all the relevant factors, the respective sale prices procured by the receivers for the two properties were their true market value, namely the best prices reasonably attainable, at their respective dates of sale. With respect to one such property the receivers had no obligation to obtain planning consent for residential use before selling in order to maximise the proceeds of sale and, as a matter of law, were under no obligation to exercise their powers to grant occupation leases of the restaurant or office premises but were entitled to market the property as a vacant freehold property in the condition in which they found it. Accordingly, both properties having been sold by the receivers for the proper price at their respective dates of sale, the claimant could establish no loss due to the conduct of the receivers. The action would therefore be dismissed.*

Adjustment between mortgagees.—A decision of the Privy Council indicates that where there are two mortgagees over one and the same property of the company, it is open to the mortgagees to agree as between themselves to vary their respective priority rights in respect of the security. The consent of the company for this purpose would not be needed. If the company wants to exclude such change of priority, the loan agreement must carry an express prohibition. The simple labelling of the charges as first or second charge would not be a clear enough restriction. *Cheah v. Equitcorp Finance Group Ltd.*, 1992 BCLC 371 (PC).

Right to take possession of charged property

A legal chargee gets the legal title to the charged property and therefore has an immediate right to possession of the property, HARMAN J. said in *Four-Maids Ltd. v. Dudley Marshall (Properties) Ltd.*, (1957) Ch 317 at 320: 'The mortgagee may go into possession before the ink is dry on the mortgage unless there is something in the contract, express or by implication, whereby he has contracted himself out of that right.' The right to

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* *Cohen v. TSB Bank plc.*, (2002) 2 BCLC 32 (Ch. D).

possession is exercisable whether or not the mortgagor has defaulted, unless there is a contrary agreement. *Western Bank Ltd. v. Schindler,* (1977) Ch 1 (CA). A mortgagee who takes possession of the mortgaged property comes under a strict and heavy liability because of the 'wilful default rule' under which a mortgagee in possession must account to the mortgagor for rents and profits which, but for the mortgagee's default or neglect, he might have received. *Chaplin v. Young (No. 1),* (1864) 33 Beav 330 : 55 ER 395.

An enquitable chargee has no right to possession of the charged property unless he is granted the right by a provision of the charge contract. *Tennant v. Trenchard* (1869) LR 4 Ch App 537; *Vacuum Oil Co. v. Ellis,* (1914) KB 693 (CA). The distinction between the rights of an equitable and a legal chargee was summarised by BUCKLEY, J. in *Re, London Pressed Hinge Co. Ltd.,* (1905) 1 Ch 576, 583: 'A legal mortgagee may take possession simply because he chooses. In so doing he accepts the responsibility of a mortgagee in possession. An equitable mortgagee must show good reason why the court should at his instance take possession by its receiver.'

The execution of a decree is only complete after attachment and sale. Until then the property remains that of the execution debtor and title does not pass to the execution creditor: Thus although in the case the goods were, at the time of appointment of the receivers, under the control of the court broker, the goods remained subject to the floating charges created by the debentures, *Lochab Brothers v. Kenya Furfural,* (1985) LRC (Comm) 737 (Kenya CA). The Court of Appeal **followed** *Mackerzie (Kenya) Ltd. v. Pharamico,* (1976) KLR 270 (Kenya).

Appointment of receiver

The debenture-holder may appoint a receiver, if the conditions give him power to do so, or apply to the court in a debenture-holders' action to appoint one. [See Section 69-A of Transfer of Property Act, 1882] A debenture-holder cannot be restrained from appointing a receiver for protecting the property charged to him merely because the appointment may cause loss to the company or its unsecured creditors. *Potters Oils Ltd.* (No. 2), *In re,* (1986) 1 All ER 890 : 1986 BCLC 98 (Ch D).

It was held to be a valid appointment of a receiver that notice of default under the debenture and appointment of receiver were posted to the defendant company on the same day. The demand for payment is not a condition precedent, unless so required, for appointment of receiver. *Kay Jay Rubber Products Ltd. v. Development Finance Co. (Kenya) Ltd.,* (1992) LRC (Comm) [Kenya CA].

Where the terms of the debenture and mortgage permitted of successive receivers by different creditors, the appointment of a receiver by one creditor and a subsequent appointment by another creditor, were both held to be valid. It was a matter of construction whether receivers could be appointed jointly and severally. The duties of receivership could be divided between receivers acting severally and should any difficulties arise, directions could be sought from the court. *Gwembe Valley Development Co. Ltd. v. Koshy (No. 2),* (2000) 2 BCLC 705 (Ch. D). The court followed *DFC Financial Services Ltd. v. Samuel,* (1990) 3 NZLR 156 and *NEC Information Systems Australia Pty. Ltd. v. Lockhart,* (1991) 2 NSWLR 518 (Aust.).

An appointment of a receiver by a debenture-holder takes effect when the document of appointment is handed to him by a person having the necessary authority in circumstances from which it may fairly be said that he was appointing a receiver, and the receiver accepts the profferred appointment, although the acceptance may be tacit. The date of the instrument is irrelevant except as a piece of evidence if the actual date of handing over is not known. *Cripps (Pharmaceuticals) Ltd. v. Wickenden,* (1973) 2 All ER 606.

Receivers have no interest, legal or equitable in the property seized : Their appointment under the terms of the debenture does not confer any right to bring proceedings in their own names. The proceedings brought in the name of the receiver instead of the name of the company were a nullity and should not have been allowed to proceed.

It was also laid down that where the appointment of receivers was made out of court and not by way of a motion in a debenture-holder's action for their appointment, the onus of proving that the receivers had been properly appointed lay upon those who were in a position to know of the relevant facts, the company itself or the debenture-holder. *Lochab Brothers v. Kenya Furfural,* (1985) LRC (Comm) 737 (Kenya CA). The court **followed** *Cecil Charles Carver v. Mackle MacJohn,* (1938/39) 18 KLR 97 (Kenya).

While there is a duty to realise proper value, it is duty which the receiver owes primarily to the debenture holders. If he thinks the interest of debenture-holders will suffer, he is not bound to give any information to the company as to the way in which and the price at which he is going to dispose of the security. He cannot be prevented from going ahead with disposal unless he has before him firm evidence that the charge would be redeemed by the company. *Gomba Holdings U.K. Ltd. v. Homan,* (1986) 3 All ER 94 : (1987) 2 Comp LJ 201 : 1986 BCLC 331 (Ch D). See also *Becker v. Bank of Nova Scotia,* (1986) LRC (Comm) 638.

A manager appointed under this section is not a manager of the company within the meaning of section 2(24). He is a manager appointed not in the interests of or for the benefit of the company but under powers contained in an instrument for realising the debts, securities or other dues of persons whose interests are secured by the instrument. Such a manager is under no duty to the company or its shareholders, and is not answerable to them for negligence, misfeasance, *etc.* See *Re, B. Johnson and Co., (Builders) Ltd.,* (1955) 2 All ER 775 : (1955) 25 Com Cases 317 (CA). But where he has been appointed by an order of Court, there is no reason why, if by any act or omission he has caused loss to the company, the company cannot, with the leave of the Court, sue him for damages or where he has misappropriated the company's moneys, call him to account.

A receiver or manager, whether appointed by the debenture-holders or otherwise, is the agent of the company for the conduct of its affairs and as such, under a duty to keep full accounts *i.e.* fuller than merely keeping abstracts of receipts and payments required by section 421. He is an accounting party to the company. For a discussion of this point, see *Smiths Ltd. v. Middleton,* (1979) 3 All ER 842 (Ch D).

The appointment of a receiver in breach of the contract was restrained by an injunction, the court saying that questions of balance of convenience *etc.* would not arise in such a case. *Sheppard & Cooper Ltd. v. TSB Bank plc.,* (1997) 2 BCLC 222 (CA).

§ See also Notes under Ss. 137 & 424 as regards to appointment of Receiver.

Foreclosure

The debenture-holder may apply to the court for foreclosure, which may extend even to the uncalled capital of the company. *Sadler v. Worley,* (1894) 2 Ch 170. But this remedy is not usual, as it is necessary for all the debenture-holders of every class to be parties to the action, *Continental Oxygen Co. Elias v. Continental Oxygen Co.,* (1897) 1 Ch 511.

The powers of foreclosure or judicial sale (which necessitate application to the court) are applicable in any event. These powers are only of any real practical use where there is a legal mortgage of specific property, which can be sold and conveyed under the mortgagee's power of sale. It should be noticed that in foreclosure proceedings, all subsequent chargees must be made parties, and that where there is a subsequent issue of debentures every debenture-holder must be made a party. *Westminster Bank Ltd. v. Residential Properties Improvement Co.,* (1938) Ch 639 : (1938) 2 All ER 374. However, in any action for foreclosure the court may instead direct a sale of the charged property and in practice this is the more usual course which is adopted.

Debenture-holders' action

If debenture is one of a series and legal proceedings are necessary, debenture-holder will normally sue on behalf of himself and all other debenture-holders of the same class in a debenture-holders' action. The claim is for—

1. a declaration that the debentures are a charge on the assets;
2. accounts and inquiries to show what is due to the debenture-holders, what assets there are, and what prior claims exist;
3. appointment of a receiver and manager;
4. enforcement of the debentures by sale or foreclosure. The company frequently consents to such an application. If so, an order is made appointing a receiver, and later a sale is ordered on a motion for judgment (see *Re, Crigglestone Coal Co., Stewart v. Crigglestone Coal Co.,* (1906) 1 Ch 523. For this purpose a statement of claim should be prepared, *Re, Dupont, Dupont v. Dupon, Ltd.,* (1906) 50 Sol Jo 206), and should be supported by evidence. The statement of claim can only be dispensed with if the company consents to the order: (*Re, Kitson Empire Lighting Co. Ltd. Higgs v. Kitson Empire Lighting Co. Ltd.,* (1910) WN 154).

The assets realised by a debenture-holders' action are applied in the following order in case of a deficiency. *Re, Glyncorrwg Colliery, Railway Debenture and General Trust Co. v. Glyncorrwg Colliery Co.,* (1926) Ch 951—

(i) costs of realisation;
(ii) costs, including remuneration of the receiver;
(iii) expenses of the debenture trust deed, including the trustees' remuneration;
(iv) the plaintiff's costs of the action;
(v) preferential creditors, if the debentures are secured by a floating charge;
(vi) the debenture-holders.

Where it appears that the proposed plaintiff in such an action has been closely concerned with the management and that his transactions with the company require investigation or his interests are adverse to those of the other debenture-holders, the court may give the conduct of the action to an independent party. *Re, Services Club Estate Syndicate; McCandlish v. Services Club Estate Syndicate,* (1930) 1 Ch 78.

Winding up petition

Debenture-holder can present a petition for winding up as he is a creditor for the amount of his principal and interest, but not for any premium payable on redemption, unless the debenture expressly so provides. *Consolidated Goldfields of South Africa v. Simmer and Jack East Ltd.,* (1913) 82 LJ Ch 214.

In the case debentures, where there is a trustee who is given all the rights of ownership, a debenture-holder as such will not be deemed to be a creditor. But in the case of any debenture where the holder of the debenture is given the right to receive or collect the interest amounts directly from the company or the debenture is a bearer bond, the holder of the debenture will be entitled to present a winding up petition as a creditor. In all cases the question will be "Is the holder of the debenture entitled to collect the dividend amounts or the principal sum without reference to the trustee"? If he is so entitled, he will be deemed to be a creditor : *Calcutta Safe Deposit Co. Ltd. v. Ranjit Mathuradas Sampat,* (1971) 41 Com Cases 1063 (Cal). See also *Narotamdas T. Toprani v. Bombay Dyeing & Mfg. Co. Ltd.,* (1990) 68 Com Cases 300 (Bom); *Re, Sholapur Spinning and Weaving Co. Ltd.,* (1965) 35 Com Cases at 165 (Bom); *Bachharaj Factories Ltd. v. Hirjee Mills Ltd.,* (1955) 25 Com Cases 227 : AIR 1955 Bom 355.

Valuation of security and proving for balance

If the company is being wound up, and his security is insufficient, he may value his security and prove for the balance of his debt or give up his security and prove for the whole debt.

The proceeds recovered by enforcing his security may be applied by the debenture-holder in payment of his costs, principal and interest up to date of payment. *Wallace v. Universal Automatic Machine Co.,* (1894) 2 Ch 547 (CA). But if his security is insuffi-

cient, and the company is insolvent, he cannot prove for interest which became due after winding up; nor can he get interest out of his security when arriving at a balance for which he can prove in the winding up. *Re, London, Windsor and Greenwich Hotels Co., Quartermaine's* case, (1892) 1 Ch 639.

A 'secured creditor' as applied to companies means a person who holds a mortgage, charge or lien on the company's property or any part of it as security for any debt due to him from the company (*vide* Definition in the Presidency Towns and Provincial Insolvency Acts).

It is not necessary for a secured creditor to prove his debt in the winding up, and he can stand wholly outside the winding up proceedings. He may rely on his security and proceed to realise his debt in the ordinary course of law, provided he proceeds with the leave of the winding up Court in the case of a winding up by the Court or under supervision. If after exhausting the security, anything more remains due to him, he may prove for the deficiency in the winding up. Or he may value the security without instituing a suit, and prove for the balance of the debt after giving credit to the assessed value. But then the liquidator may redeem the security at his valuation. Or, he may surrender the security and tender proof of his whole debt. See *Ranganathan M.K. v. Government of Madras,* AIR 1955 SC 604 : (1955) 25 Com Cases 344.

In the case of a secured creditor who desires to purchase the property, if the Court or the liquidator does not want to redeem the security, the amount of the security cannot be set-off against the sale price. *See Raja Sharda Narayan Singh & Co. Ltd. v. Official Liquidator,* (1963) 33 Com Cases 905 (DB) (All) : Secured creditor is entitled to interest till date of total satisfaction of his claim, to the extent to which the security is sufficient to pay his debt. *K.V. Lakshminarayana Sastry v. Vijaya Commercial Bank,* (1963) 33 Com Cases 49 (AP).

In *Western Intelligence Ltd. v. KDO Label Printing Machines,* (1998) BCC 472 the court explained the law on release by a debentureholder of assets from the security created by a debenture. Guidance was also given on the need to value goodwill and intellectual property rights on business transfers.

Transfer of matured debentures to Investor Education and Protection Fund.— The amount of matured debentures and interest accrued thereon which have remained unclaimed and unpaid for a period of seven (7) years from the date they became due for payment are to be credited to the Investor Education and Protection Fund established under section 205C of the Act.

Interpretation of guidelines

In *Narendra Kumar Maheshwari v. Union of India,* AIR 1989 SC 2138, the Supreme Court observed *inter alia* as follows:

"Guidelines are issued by Governments and statutory authorities in various types of situations. Where such guidelines are intended to clarify or implement the conditions and requirements precedent to the exercise of certain rights conferred in favour of citizens or persons and a deviation therefrom directly affects the rights so vested, the persons whose rights are affected have a clear right to approach the court for relief. Sometimes guidelines control the choice of persons competing with one another for the grant of benefits, largesses or favours and, if the guidelines are departed from without rhyme or reason, an arbitrary discrimination may result which may call for judicial review. In some other instances (as in the *Ramanna Shetty's* case), the guidelines may prescribe certain standards or norms for the grant of certain benefits and a relaxation of, or departure from, the norms may affect persons, not directly but indirectly, in the sense that though they did not seek the benefit or privilege as they were not eligible for it on the basis of the announced norms, they might also have entered the fray had the relaxed guidelines been made known. In other words, they would have been potential competitors, in case any relaxation or departure were to be made. In a case of the present type, however, the guidelines

operate in a totally different field. The guidelines do not affect or regulate the right of any person other than the company applying for consent. The manner of application of these guidelines, whether strict or lax, does not either directly or indirectly, affect the rights or potential rights of any others or deprive them, directly or indirectly, of any advantages or benefits to which they were or would have been entitled. In this context, there is only a very limited scope for judicial review on the ground that the guidelines have not been followed or have been deviated from. Any member of the public can perhaps claim that such of the guidelines as impose controls intended to safeguard the interests of members of the public investing in such public issues should be strictly enforced and not departed from, departure therefrom will take away the protection provided to them. The scope for such challenge will necessarily be very narrow and restricted and will depend to a considerable extent on the nature and extent of the deviation. For instance, if debentures were issued which provide no security at all, or if the debt-equity ratio is 6,000:1 (as alleged) as against the permissible 2:1 (or thereabouts), a court may be persuaded to interfere. A court, however, would be reluctant to interfere simply because one or more of the guidelines have not been adhered to even where there are substantial deviations, unless such deviations, are, by nature and extent such as to prejudice the interests of the public, which it is their avowed object to protect. Per contra, the court would be inclined to perhaps overlook or ignore such deviations, if the object of the statute or public interest warrant, justify or necessitate such deviations in a particular case. This is because guidelines, by their very nature, do not fall into the category of legislation, direct, subordinate or ancillary. They have only an advisory role to play and non-adherence to or deviation from them is necessarily and implicitly permissible, if the circumstances of any particular fact or law situation warrants the same. Judicial control takes over only where the deviation either involves arbitrariness or discrimination or is so fundamental as to undermine a basic public purpose which the guidelines and the statute under which they are issued are intended to achieve." In the instant case the court held that the Controller of Capital Issues had acted in substantial compliance with the guidelines as well as objectively and *bona fide*. [The Office of the Controller of Capital Issues has since been abolished with the repeal of the Capital Issues (Control) Act and the setting up of SEBI under SEBI Act, 1992].

Jurisdiction for Investor Guidance, Grievances and Complaints

For non receipt of debenture certificates, bonds, transfer, consolidation, interest, redemption amount, exchange, or allotment letters, endorsement, duplicate on submission of indemnity bonds, interest on delayed interest payment, interest on delayed redemption amount a complaint lies before the SEBI. For the format of the complaint and addresses of the forums, see *Appendix* 234.

Investments in NCDs by NRIs and OCBs

FEM (Borrowing and Lending in Rupees) Regulations, 2000.—FEM (Borrowing and Lending in Rupees) Regulations, 2000 framed under FEMA, 1999 relate to borrowing and lending in rupees by a person resident in India from/to a person resident outside India.

Regulation No. 5 provides for general permission for borrowings by an Indian company from NRIs/OCBs on non-repatriation/repatriation basis subject to terms and conditions specified therein by issue of non-convertible debentures. These provisions correspond to the provisions of erstwhile Notification No. FERA 213/99-RB dated 1st November 1999 [cf. paragraph 10C.7(ii) and 10C.15 of the ECM].

Redemption of NCDs—

AP (DIR Series) Circular No. 39, dt. 5-11-2002.—In terms of Regulation 5 of Notification No.FEMA 4/2000-RB dated 3rd May 2000, general permission has been given to companies incorporated in India to borrow in rupees by way of issue of non-convertible debentures subject to certain conditions, on repatriation or non-repatriation basis, from a non-resident Indian or a person of Indian origin resident outside India or an overseas corporate body (OCB).

It is clarified that, in view of Regulation 5 referred to above, Indian companies, which were granted permission by Reserve Bank under FERA to issue NCDs on repatriation basis, subject to the condition that the company would seek prior permission of the Reserve Bank for repatriation of redemption proceeds, hereafter do not require prior permission of Reserve Bank to remit the redemption proceeds of the NCDs/PCDs issued by them, provided, they have complied with all other conditions stipulated in the relevant approval letter.

Regulation No. 6 provides for restrictions on use of borrowed fund.

Any borrowing or lending in rupees by a person resident in India from/to a person resident outside India which is not covered by the provisions of the Act or Rules or these Regulations would require approval of Reserve Bank [*vide Annexure II to AD (MA Series) Circular No. 11 dt. 16-5-2000, issued by RBI*].

General permission for borrowing in rupees by Indian companies from NRI etc. by public issue of NCDs [Regn. 5(1)]

(1) Subject to the provisions of sub-regulations (2) and (3), a company incorporated in India may borrow in rupees on repatriation or non-repatriation basis, from a non-resident Indian or a person of Indian origin resident outside India [1][* * * * *], by way of investment in Non-convertible Debentures (NCDs) subject to the following conditions;

(i) the issue of Non-convertible Debentures (NCDs) is made by public offer;

(ii) the rate of interest on such Non-convertible Debentures (NCDs) does not exceed the prime lending rate of the State Bank of India as on the date on which the resolution approving the issue is passed in the borrowing company's General Body Meeting, plus 300 basis points,

(iii) the period for redemption of such Non-convertible Debentures (NCDs) shall not be less than three years;

(iv) the borrowing company does not and shall not carry on agricultural/plantation/real estate business/Trading in Transferable Development Rights (TDRs) or does not and shall not act as Nidhi or Chit Fund company;

(v) the borrowing company files with the nearest office of the Reserve Bank, not later than 30 days from the date -

(A) of receipt of remittance for investment in Non-convertible Debentures (NCDs), full details of the remittances received, namely; (a) a list containing names and addresses of Non-resident Indians (NRIs)/[2][* * * * *] who have remitted funds for investment in Non-convertible Debentures (NCDs) on repatriation and/or non-repatriation basis, (b) amount and date of receipt of remittance and its rupee equivalent; and (c) names and addresses of authorised dealers through whom the remittance has been received;

(B) of issue of Non-convertible Debentures (NCDs), full details of the investment, namely; (a) a list containing names and addresses of Non-resident Indians (NRIs)/[2][* * * * *] and number of Non-convertible Debentures (NCDs) issued to each of them on repatriation and/or non-repatriation basis and (b) a certificate from the Company Secretary of the borrowing company that all provisions of the Act, rules and regulations in regard to issue of Non-convertible Debentures (NCDs) have been duly complied with.

Additional conditions for Issue of NCDs on *repatriation* basis [Regn. 5(2)

(2) The borrowing by issue of non-convertible debentures on repatriation basis shall be subject to the following additional conditions, namely:

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1. The words "or an overseas corporate body (OCB)' omitted by Notfn. FEMA 101/2003-RB, dt. 3-10-2003.
2. The words "Overseas Corporate Bodies (OCBs)" omitted by Notfn. FEMA 101/2003-RB, dt. 3-10-2003.

(a) the percentage of Non-convertible Debentures (NCDs) issued to Non-resident Indians (NRIs)[3][* * * * *] to the total paid-up value of each series of Non-convertible Debentures (NCDs) issued shall not exceed the ceiling prescribed for issue of equity shares/convertible debentures for foreign direct investment in India as specified by the Reserve Bank from time to time, under the relevant regulations, and

(b) the amount of investment is received by remittance from outside India through normal banking channels or by transfer of funds held in the investor's Non-resident External (NRE)/Foreign Currency Non-resident (FCNR) account maintained with an authorised dealer or an authorised bank in India;

Additional conditions for Issue of NCDs on *non-repatriation* basis [Regn. 5(3)

(3) The borrowing by issue of non-convertible debentures (NCDs) on non-repatriation basis shall be subject to the following additional conditions, namely:

(a) the amount of investment is received either by remittance from outside India through normal banking channels or by transfer of funds held in the investor's Non-resident External (NRE)/Non-resident Ordinary (NRO)/Foreign Currency Non-resident (FCNR)/Non-resident Non-repatriable (NRNR)/Non-resident Special Rupee (NRSR) account maintained with an authorised dealer or an authorised bank in India ,

(b) where the investment is made out of funds held in Non-resident Special Rupee (NRSR) account, the interest on such Non-convertible Debentures (NCDs) shall also not be repatriable outside India; and the maturity proceeds and interest on such debentures are credited only to the Non-resident Special Rupee (NRSR) account of the investor.

Restriction on use of borrowed funds [Regn. 6].—No person resident in India who has borrowed in rupees from a person resident outside India,—

(1) shall use such borrowed funds for any purpose except in his own business other than—

(i) the business of chit fund, or

(ii) as Nidhi Company , or

(iii) agricultural or plantation activities or real estate business, or construction of farm houses, or

(iv) trading in Transferable Development Rights (TDRs).

(2) shall use such borrowed funds for any investment, whether by way of capital or otherwise, in any company or partnership firm or proprietorship concern or any entity, whether incorporated or not, or for relending..

Explanation.—For the purpose of sub-clause (iii) of clause (1), real estate business shall not include development of townships, construction of residential/ commercial premises, roads or bridges [*Reg. 6*].

AP (DIR Series) Circular No. 14, dt. 16-9-2003.—An Indian company shall not borrow in rupees on repatriation and non-repatriation basis from OCBs by way of investment in Non-convertible Debentures (NCDs). [*Para 3(g)*].

Guidelines regarding floatation of bonds by public sector undertakings

Press Release, dated 6-1-1992.—The scheme is applicable to all such Public Sector Enterprises (PSEs) whose equity share capital is fully owned by the Central Government. Subject to the approval of Department of Economic Affairs, bonds can be issued by existing as well as new corporate undertakings including Finance Corporations that may be set up in the specified sectors like railways, etc. However, approval for tax exemptions will be obtained from CBDT in the Ministry of Finance before approaching public etc. for subscription.

§ For text of the Guidelines see *Appendix* 277.

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3. The words "Overseas Corporate Bodies (OCBs)" omitted by Notfn. FEMA 101/2003-RB, dt. 3-10-2003.

Public Issue of Bonds and other Securities by State Level PSU's

The Centre has clarified that the public issue of bonds and other types of securities by State Public Sector Enterprises should be governed by the guidelines issued by the Securities Exchange Board of India (SEBI) in force of the relevant time. This has been done with a view to protect the interests of investors and also to ensure due accountability of funds raised through such instruments. The State level public sector enterprises issuing such securities should approach the market on their own strength and should not arrange the securities to be guaranteed by the State Government concerned in regard to repayment of principal or interest. This announcement comes in the wake of several requests received from time to time by the Centre from public sector companies owned by the State Governments wholly or in part, seeking permission for public issue of bonds, non-convertible debentures and other types of debt instruments for project financing. [*Source : PIB Press Release, dated 29-10-1992*].

Guidelines for listing of public sector enterprises securities in relaxation of Rule 19(2)(b) of Securities Contracts Regulations

Text of Guidelines and Press Releases.—For text of the Guidelines and Press Release, see *Appendix* 251.

Relevant Rules

The Public Companies (Terms of issue of Debentures and Raising of Loans with option to convert such Debentures or Loans into Shares) Rules, 1977. For the text of the rules, see under Notes to section 81.

ICSI Guidance Note on Compliance Certificate (August 2003)

The ICSI has issued a Check List for issue of Compliance Certificate under proviso to Sec. 383A(1) in respect of the matters specified under Rule 3 of the Companies (Compliance Certificate) Rules, 2001. Paragraph 19 under Rule 3 relates to issue of capital and securities and reads as follows:

Paragraph-19.—**The company has issued..... shares/ debentures/other securities during the financial year and complied with the provisions of the Act.**

Prescribed Check List

Issue of Debentures [*Item (d)*]

Check whether:

(i) no debentures are issued which carry any voting right at any meeting of the company, whether generally or in respect of particular class of business.

(ii) the company has appointed one or more debenture trustees before issue of prospectus or letter of offer to the public for subscription of its debentures;

(iii) the debenture trustee does not suffer from any of the disqualifications with reference to the provisions of proviso to section 117B(1);

(iv) the company has stated on the face of such prospectus or letter of offer that the trustees have given their consent;

(v) a Trust Deed has been executed within such period and in such form as prescribed for securing any issue of debentures;

(vi) a copy of Trust Deed is made available for inspection to any member or debenture holder;

(vii) a copy of the Trust Deed has been forwarded on payment of requisite fee to any member or debenture-holder;

(viii) company has created a debenture redemption reserve for the redemption of debentures to which adequate amounts have been credited, from out of its profits every year until such debentures are redeemed;

(ix) the amounts credited to the debenture redemption reserve were not utilised by the company except for the purpose of redemption of such debentures;

(x) certificate of registration given under section 132 has been endorsed on every debenture or certificate of debentures stock issued by the company and the payment of which is secured by the charge so registered;

(xi) debenture certificates have been delivered within the time prescribed under section 113 of the Act;

(xii) the company has complied with the Order of the Company Law Board*, if any, with regard to incurring of any further liabilities;

(xiii) the company had re-issued the redeemed debentures in accordance with section 121; if so, check that such re-issue was not prohibited by company's Articles, in the conditions of issue or in any contract entered into by the company or the company has manifested its intention that the debentures shall be cancelled.

§ For the text of the Companies (Compliance Certificate) Rules, 2001, see *Appendix* 38.

§ For the full text of the Guidance Notes on Compliance Certificate and for Specimen Compliance Certificate Form as issued by ICSI see *Appendix* 312.

Secretarial Practice Notes : No Debentures with voting rights

Check that the company has not issued any debentures carrying voting rights.

Documents Involved: 1. Prospectus, 2. Minutes of the Board/General Meeting, 3. Debenture Trust Deed, 4. Charge filed with the Registrar.

[1][*S. 117A. **Debenture trust deed.**—(1) A trust deed for securing any issue of debentures shall be in such form and shall be executed within such period as may be prescribed.*

(2) A copy of the trust deed shall be open to inspection to any member or debenture holder of the company and he shall also be entitled to obtain copies of such trust deed on payment of such sum as may be prescribed.

(3) If a copy of the trust deed is not made available for inspection or is not given to any member or debenture holder, the company and every officer of the company who is in a default, shall be punishable, for each offence, with fine which may extend to five hundred rupees for every day during which the offence continues.]

NOTES

Companies (Amendment) Act, 2000

Sections 117A, 117B and 117C inserted by the Amendment Act, 2000 contain provisions governing debenture trust deed, appointment and duties of debenture trustees and creation of debenture redemption reserve.

Clause 103 of the Companies Bill, 1997 contained provisions analogous to section 117A. Notes on clause 103 stated—"This is a new clause which prescribes debenture trust deed and right to obtain copies and to inspect it."

Purpose and nature of trust deed

The issue of debentures is commonly secured by a trust deed by which the property forming the security is charged by way of mortgage to the trustees. The trust deed pro-

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* **Power transferred to the Central Government from the commencement of the Companies (Second Amendment) Act, 2002 (11 of 2003).**

1. Ins. by the Companies (Amendment) Act, 2000 (53 of 2000), s. 48 (w.e.f. 13-12-2000).

vides, the terms and conditions on which the charge is held and may be enforced. The advantages of the creation of a trust deed are:—

(1) the trustee can act expeditiously and effectively in safeguarding the interests of the debenture-holders; and enforcing the security on their behalf;

(2) they will act as watchdogs in seeing and insisting that the company's obligations under the trust deed are carried out properly;

(3) they are generally empowered to settle and adjust matters of dispute with the company;

(4) in cases of doubt or difficulty they can convene meetings and enable the debenture-holders to meet and discuss and authorise the trustees to pursue any course of action beneficial to the debenture-holders as a whole.

Going through the statutory provisions and authorities, a Full Bench of the Karnataka High Court in *Chief Controlling Revenue Authority v. State Bank of Mysore,* AIR 1988 Kant 1, 5 : (1989) 65 Com Cases 427 (FB), noted that a debenture trust deed has to be created expressly by an instrument of trust; the author of such trust transfers the properties movable or immovable to the trust and the trustee or the trustees hold such properties in trust for the benefit of the beneficiary, *i.e.*, the debenture-holder, to be used in the event of default of payment of interest or principal amount of the debt advanced as per terms agreed by selling such properties. The Court referred to the following passage in PALMER'S COMPANY LAW [at p. 5 of the AIR 1988 Kant 1 : (1989) 65 Com Cases 427 (FB)] (Vol. 1, 23rd edition): "A trust deed usually contains a legal mortgage of the freehold and leasehold properties, *e.g.*, in the case of a brewery, the brewery and tiled houses, and a general charge by way of floating security on the rest of the assets and undertaking. Under the Law of Property Act, 1925, section 87, the legal mortgage takes the form of a demise to the trustees for a term of years or a charge by way of legal mortgage". (Now see para 45.19, 24th Edn., 1987 : Vol. 2 (25th Edn.), para 13.148).

Citing further from the same work the court said that we notice under the heading "Trust Deeds" the following: "Debentures and debenture-stock are often secured by a trust or covering deed conveying property of the company to trustees in favour of the debenture-holders, charging other property and containing a number of ancillary provisions regarding the respective rights of the company and the debenture-holders. Whether there should be a trust deed or not must depend on the circumstances; where the debentures are issued only for a temporary purpose, *e.g.*, to bankers as security for an overdraft or to other persons for a short-term, or are to be taken up by the directors, a deed may be dispensed with; but where the transaction is of some magnitude, in particular where large-scale borrowing by companies from the public is in question a trust deed is commonly used. The advantages of a trust deed may be briefly summarised as follows:

1. It constitutes trustees charged with the duty of looking after the rights and interests of debenture-holders.

2. The debenture-holders can by these trustees enter and sell the property comprised in the security.

3. A legal estate is sometimes vested in the trustees with the protection which is conferred thereby".

The question before the Full Bench was whether a debenture trust deed when presented for registration under the Registration Act has to be stamped like a deed of mortgage or like a bond. The conclusion of the Court was that it does not come into the category of a mortgage and has, therefore, to be stamped simply as a trust deed.

The trust deed constitutes a mortgage over the company's properties, to secure payment to debenture-holders. The debenture-holders are the *cestai que trust* of the trust created by the deed. *CIT v. Chowringhee Properties Ltd.,* (1944) 14 Com Cases 201, 203 :

AIR 1945 Cal 513. The debenture trust deed is undoubtedly an express trust in every sense of the term because there the property is vested in the trustees who are expressly mentioned in the document. *Barkat v. Daulat,* ILR (1882) 4 All 187; *Bhurabhai Jamnadas v. Bai Rukmani,* ILR (1908) 32 Bom 394.

Time limit for execution of trust deed [Sub-section (1)]

There was a general complaint about delay in execution of the debenture trust deed with the trustees, with the result that the companies also delayed issue of debenture certificates. Sub-section (1) of section 117A lays down the mandatory requirement for companies to execute the trust deed within the prescribed period and in the prescribed format. Section 117C also makes it obligatory for companies to create security in favour of debenture holders within 3 months from the date of issue of debentures.

Format and Contents of trust deed [Sub-section (1)]

The trust deed securing a debenture issue must be executed in the Form prescribed by the Central Government.

SEBI Guidelines 2000—Time limit for execution of trust deed

Clause 10.2.3 of Chapter X of SEBI Guidelines, 2000 which lay down 'Guidelines for issue of Debt Instruments' provides that a trust deed shall be executed by the issuer company in favour of the debenture trustees within three months of the closure of the issue. A fresh trust deed should be executed at the time of roll-over of PCDs/NCDs. [*Clause 10.7.1(d)*]

Contents of Trust Deed under SEBI Regulations.—Reg. 14 of SEBI (Debenture Trustees) Regulations, 1993 provides that 'every debenture trustee shall amongst other matters accept the trust deed which contain matters specified in Schedule IV to the Regulations." Schedule IV (Contents of Trust Deed) provides as follows :

Every debenture trustee shall ensure that the trust deed executed between a body corporate and debenture trustee shall amongst others provide for the following, namely:—

(a) provisions for redressal of grievances of debentureholders;
(b) time limit for creation of the security for the issue of debentures as specified in SEBI (DIP) Guidelines, 2000;
(c) obligation not to create further charge or encumbrance of the trust property without the prior approval of the trustee;
(d) obligations of the body corporate to the debenture trustees and debentureholders;
(e) events constituting defaults;
(f) procedure for appointment of new trustees and their removal;
(g) removal of debenture trustees on a resolution passed by at least 75% of the total debenture holders of a body corporate;
(h) rights of debentureholders in case of default by the body corporate;
(i) fee or commission of debenture trustees;
(j) circumstances when the security will become enforceable;
(k) redemption of the debentures in terms of the issue to the debentureholders;
(l) obligation to convert the debentures into equity in accordance with the terms of the issue;
(m) debt-equity ratio and debt service coverage ratio;
(n) method and mode of preservation of assets charged as security for debentureholders;
(o) circumstances specifying when the security may be disposed of or leased out with the approval of trustees;

(p) procedure for allowing inspection of charged assets by trustees or any person or persons authorised by them;

(q) obligation to inform debenture trustee about any change in nature and conduct of business by the body corporate before such change;

(r) obligation of body corporate to keep the debenture trustee informed of all the orders, directions or notices of court or tribunal affecting or likely to affect the charged assets;

(s) obligation to inform debenture trustee of any change in composition of its Board of directors;

(t) obligations of the body corporate to forward a quarterly report to debenture trustees containing the following particulars:

(i) updated list of the names and addresses of the debentureholders;

(ii) details of interest due but unpaid and reasons thereof;

(iii) the number and nature of grievances received from debentureholders and resolved by the body corporate;

(iv) a statement that the assets of the body corporate which are available by way of security are sufficient to discharge the claims of the debentureholders as and when they become due.

§ For text of the SEBI (Debenture Trustees) Regulations, 1993 see *Appendix* 218.

Inspection and copies of trust deed [Sub-section (2)]

Sub-sections (1) and (4) of sec. 118 also contain provisions relating to right of members/debentureholder to obtain copies of and to inspect trust deeds.

Penalty for default [Sub-section (3)]

The trust deed is open for inspection by any member of debenture holder of the company on payment of prescribed sum. He can also obtain copy of trust deed on payment of prescribed sum. In case of default, the company and every officer in default is punishable with fine upto Rs. 500 for each day of default.

Compoundable offence.—The offence is compoundable under section 621A.

Provisions for supply of copy of trust deed are also contained in section 118(1) within 7 days of making the demand. In section 117A(2) no such time limit has been fixed.

Failure or refusal to furnish copy of trust deed is punishable under section 118(2) with fine upto Rs. 500 and further fine upto Rs. 200 for every day during which the offence continues. In contrast the default under section 117A(3) is punishable only with fine of Rs. 500 for every day during which the offence continues.

§ See also Notes under section 118.

[1][**S. 117B. Appointment of debenture trustees and duties of debenture trustees.**—(1) No company shall issue a prospectus or a letter of offer to the public for subscription of its debentures, unless the company has, before such issue, appointed one or more debenture trustees for such debentures and the company has, on the face of the prospectus or the letter of offer, stated that the debenture trustee or trustees have given their consent to the company to be so appointed:

Provided that no person shall be appointed as a debenture trustee, if he—

(a) beneficially holds shares in the company;

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1. Ins. by the Companies (Amendment) Act, 2000, (53 of 2000) s. 48 (w.e.f. 13-12-2000).

(b) is beneficially entitled to moneys which are to be paid by the company to the debenture trustee;

(c) has entered into any guarantee in respect of principal debts secured by the debentures or interest thereon.

(2) Subject to the provisions of this Act, the functions of the debenture trustees shall generally be to protect the interest of holders of debentures (including the creation of securities within the stipulated time) and to redress the grievances of holders of debentures effectively.

(3) In particular, and without prejudice to the generality of the foregoing functions, a debenture trustee may take such other steps as he may deem fit—

(a) to ensure that the assets of the company issuing debentures and each of the guarantors are sufficient to discharge the principal amount at all times;

(b) to satisfy himself that the prospectus or for letter of offer does not contain any matter which is inconsistent with the terms of the debentures or with the trust deed;

(c) to ensure that the company does not commit any breach of covenants and provisions of the trust deed;

(d) to take such reasonable steps to remedy any breach of the covenants of the trust deed or the terms of issue of debentures;

(e) to take steps to call a meeting of holders of debentures as and when such meeting is required to be held.

(4) Where at any time the debenture trustee comes to a conclusion that the assets of the company are insufficient or are likely to become insufficient to discharge the principal amount as and when it becomes due, the debenture trustee may file a petition before the [2][*Central Government*] and the [2][*Central Government*] may, after hearing the company and any other person interested in the matter, by an order, impose such restrictions on the incurring of any further liabilities as the [2][*Central Government*] thinks necessary in the interests of holders of the debentures.]

[3][*Provided that in the case of revival and rehabilitation of a sick industrial company under Part VIA, the provisions of this section shall have effect as if for the words "Central Government", the word "Tribunal" had been substituted.*]

NOTES

General Note : As and when the Companies (Second Amendment) Act, 2002 (11 of 2003) comes into force, the power under this section shall become transferred to the Central Government to be exercised by it in place of the Company Law Board. The commentary should be read keeping this change in mind.

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2. Subs. for "Company Law Board" by the Companies (Second Amendment) Act, 2002 (11 of 2003), s. 17.
3. Ins. by the Companies (Second Amendment) Act, 2002 (11 of 2003), s. 17.

Companies (Amendment) Act, 2000

Section 117B inserted by the Amendment Act, 2000 relates to appointment of debenture trustees and enumerates their duties. The Company Law Board has been empowered, on a petition of the debenture trustee, to restrain the company from incurring further liabilities.

Companies (Second Amendment) Act, 2002 [11 of 2003]

The powers of Company Law Board under this section have been conferred on the Central Government. Consequential changes have accordingly been made in the section. As per the Bill, the powers of CLB were initially proposed to be transferred to the Tribunal constituted under Part 1B of the Act. Notes on Clauses of the Bill stated thus:

Notes on Clause.— This clause seeks to amend sections 111, 111A, 113, 117B, 117C and 118 of the Companies Act, 1956 relating to power to refuse registration of transfer of shares or interest of a Member or debentures and appeal against such refusal, rectification of register on transfer, limitation of time for issue of certificates, appointment of debenture trustees and duties of debenture trustees, liability of company to create security and debenture redemption reserve and right to obtain copies of and inspect trust deed. The Company Law Board has been conferred upon certain powers under these sections. It is proposed to confer these powers of the Company Law Board upon the Tribunal. These amendments are of consequential nature. (*Clause* 14 of the Companies (Amendment) Bill, 2001).

Scope of section

Before the issue of prospectus or letter of offer for right issue for subscription of debentures, the company has not only to appoint the trustees, but has also to state on the face of the said documents that the trustees have given their consent to act as such. The trustees are statutorily required to protect the interests of the debentureholders and redress their grievances, in case the company defaults in the payment of interest or repayment of the principal amount on redemption, as per terms and conditions of issue of debenture.

The provisions of this section do not apply to debentures issued on private placement basis. However, in view of the provisions of section 117C, the company has to create security in favour of debenture-holders, which necessarily involves appointment of trustees.

§ Also see proviso to sub-section (3) of section 67.

Appointment of debenture trustee [Sub-section (1)]

Appointment of debenture trustee(s) has been made compulsory in the case of a public issue of debentures through prospectus and rights issue of debentures.

SEBI Guidelines 2000.—As per clause 10.2.1 of Chapter X of the Guidelines, appointment of a debenture trustee is compulsory and has to be made in accordance with the provisions of the Act.

Disqualification for appointment as debenture trustees [Proviso to sub-section (1)]

A person (a) who beneficially holds shares in the company, (b) who is beneficially entitled to moneys which are due to debenture trustee, and (c) who has given any guarantee in respect of debts secured by debentures or interest thereon, is not eligible for appointment as debenture trustee.

SEBI (Debenture Trustees) Rules, 1993.—As per Rule 3, no person shall act as a debenture trustee without obtaining registration certificate from SEBI under the Regulations.

SEBI (Debenture Trustees) Regulation, 1993.—Under Regulation 7, no person shall be entitled to act as a debenture trustee unless he is either :

(a) a scheduled bank carrying on any commercial activity;

(b) a public financial institution; or

(c) an insurance company; or

(d) a body corporate.

Consent to act as debenture trustee [Sub-section (1)]

Consent to act as such must be obtained from the person(s) proposed to be appointed as debenture trustee(s).

SEBI (Debenture Trustees) Regulation, 1993.—Reg. 13 also requires that the issuer company should obtain the written consent of the debenture trustee to act as such under trust deed for securing issue of debentures, *before* the issue of debentures.

Disclosure in the offer document.— The names of debenture trustees must be stated in the offer document and also in all the subsequent perodical communication sent to the debentures holders. [*vide* Clause 10.2.2 of Chapter X of SEBI Guidelines, 2000] [*Subs. by SEBI Circular No. 11, dt. 14-8-2003*].

Functions of debenture trustees [sub-sections (2) to (4)]

The debenture trustees have been charged with certain specific responsibilities as specified in sub-section (3), with a view to safeguard the interests of the debentureholers. They are required to closely watch the compliance of the terms of issue of debentures and to take necessary steps, legal or otherwise, in this regard.

The trustees may approach the Company Law Board for imposition of restrictions on incurring of further liabilities by the company, where the assets of the company are not sufficient to discharge its liability towards debenture-holders.

The duties of debenture trustees specified in sub-sections (2) and (4) are to be seen in s. 78 of the Malaysian Companies Act.

Specific functions of the debenture trustees relate to—

(*a*) sufficiency of the assets of the company and the guarantors to discharge the principal amount;

(*b*) consistency of the disclosures made in the offer document with the terms of the issue and trust deed;

(*c*) ensuring that there is no breach of the covenants or trust deed by the company;

(*d*) remedial steps if there be any such breach;

(*e*) power to call a meeting of debenture holders.

Duties of debenture trustees under SEBI (Debenture Trustees) Regulations, 1993

Regs. 15 and 18 lay down the duties of debenture trustees.

(1) It shall be the duty of every debenture trustee to:

(a) call for periodical reports from the body corporate;

(b) inspect books of accounts, records, registers of the body corporate and the trust property to the extent necessary for discharging his obligations;

(c) take possession of trust property in accordance with the provisions of the trust deed;

(d) enforce security in the interest of the debenture holders;

(e) do such acts as are necessary in the event the security becomes enforceable;

(f) carry out such acts as are necessary for the protection of the debenture holders and to do all things necessary in order to resolve the grievance of the debenture holders;

(g) ensure that:

(i) in case where the allotment letter has been issued and debenture certificate is to be issued after registration of charge, the debenture certificates have been despatched by the body corporate to the debenture holders within 30 days of the registration of the charge with the Registrar of Companies.

(ii) debenture certificates have been despatched to the debenture holders in accordance with the provisions of the Companies Act;

(iii) interest warrants for interest due on the debentures have been despatched to the debenture holders on or before the due dates;

(iv) debenture holders have been paid the monies due to them on the date of redemption of the debentures;

(h) exercise due diligence to ascertain whether or not the assets of the body corporate which are available by way of security or otherwise are sufficient or are likely to be or become sufficient to discharge the claims of debenture holders as and when they become due;

(i) exercise due diligence to ensure compliance by the body corporate with the provisions of the Companies Act, the listing agreement of the stock exchange or the trust deed;

(j) to take appropriate measures for protecting the interest of the debenture holders as soon as any breach of the trust deed or law comes to his notice;

(k) to ascertain that the debentures have been converted or redeemed in accordance with the provisions and conditions under which they are offered to the debenture holders;

(l) inform the Board immediately of any breach of trust deed or provision of any law;

(*m*) appoint a nominee director on the board of the body corporate in the event of,

(*i*) two consecutive defaults in payment of interest to the debenture holders; or

(*ii*) default in creation of security for debentures; or

(*iii*) default in redemption of debentures.

(*n*) communicate to the debenture holders on half yearly basis the compliance of the terms of the issue by the body corporate, defaults, if any, in payment of interest or redemption of debentures and action taken therefor.

(2) A debenture trustee shall call or cause to be called by the body corporate a meeting of all the debenture holders on:

(a) a requisition in writing signed by at least one-tenth of the debenture holders in value for the time being outstanding; or

(b) the happening of any event, which constitutes a default or which in the opinion of the debenture trustees affects the interests of the debenture holders. [*Regulation 15*].

Duty of debenture trustee to furnish information to SEBI

Every debenture trustee shall as and when required by SEBI submit the following information and documents namely:

(a) the number and nature of the grievances of the debenture holders received and resolved;

(b) copies of the trust deed;

(c) non-payment or delayed payment of interest to debenture holders, if any, in respect of each issue of debentures of a body corporate;

(d) details of despatch and transfer of debenture certificates giving therein the dates, mode, *etc.*;

(e) any other particular or document which is relevant to debenture trustee. [*Regulation 18*].

Debenture Trustees to Appoint Compliance Officer.—(1) Every debenture trustee shall appoint a compliance officer who shall be responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions etc., issued by the Board or the Central Government and for redressal of investors' grievances.

(2) The compliance officer shall immediately and independently report to the Board and non-compliance observed by him. [*Reg.17A*].

Duties/powers of Debenture Trustees under SEBI Guidelines, 2000.—Chapter X of SEBI Guidelines, 2000 provides 'Guidelines for issue of Debt Instruments'. The duties/ powers of debenture trustees under the Guidelines of Chapter X are set out below :

Trustees to the debenture issue shall be vested with the requisite powers for protecting the interest of debenture holders including a right to appoint a nominee director on the Board of the company in consultation with institutional debenture holders [*Clause 10.2.4*].

The debenture trustee shall ensure compliance of the following:

(a) It shall obtain reports from the lead bank, regarding monitoring progress of the project;

(b) It shall monitor utilization of funds raised in the debenture issue [*Subs. by SEBI Circular No. 11, dt. 14-8-2003*].

(c) Trustees shall obtain a certificate from the company's auditors:

(i) in respect of utilisation of funds during the implementation period of projects;

(ii) in the case of debentures for working capital, at the end of each accounting year.

(d) Debenture issues by companies belonging to the groups for financing replenishing funds or acquiring share holding in other companies shall not be permitted.

Explanation:.—The expression 'replenishing of funds or acquiring shares in other companies' shall mean replenishment of funds or acquiring share holdings of other companies in the same group. In other words, the company shall not issue debentures for acquisition of shares/providing loan to any company belonging to the same group. However, the company may issue equity shares for purposes of repayment of loan to or investment in companies belonging to the same group.

(e) The debenture trustees shall supervise the implementation of the conditions regarding creation of security for the debentures and debenture redemption reserve [*Clause 10.2.6*].

Compliance certificate.—The debenture trustee shall submit a certificate of compliance with clauses 10.7.1.1, (conditions relating to rollover of PCDs/NCDs by company not being in default), 10.7.1.1A (conditions relating to rollover of PCDs/NCDs by company being in default) or 10.7.1.2 (conversion of PCDs/NCDs into equity capital), as the case may be, to the merchant banker which shall be filed with the Board within 15 days of the closure of the rollover or conversion. [*Clause 10.7.1.3*] [*Subs. by SEBI Circular No. 11, dt. 14-8-2003*].

In case of a debenture issue, the lead merchant banker shall also furnish to the Board a due diligence certificate given by the debenture trustee in the format specified in Schedule IIIA along with the draft offer document. [*Clause 5.3.3.1A*] [*Ins. by SEBI Circular No. 11, dt. 14-8-2003*].

The lead managers who are responsible for conducting due diligence exercise with respect to contents of the offer document, as per *inter-se* allocation of responsibilities shall sign due diligence certificate. [*Clause 5.3.3.3*] [*Subs. ibid*].

Power of Company Law Board to restrict creation of further liabilities [Sub-sec. (4)]

The debentures trustee may approach the Company Law Board in case the assets of the company are insufficient to discharge the principal amount of debentures as and when it

is due, for imposing restrictions on creating further liabilities by the company. The petition should be filed before the date of redemption of the debentures.

***Petition to CLB.**—A petition under sub-section (4) shall be filed in Form No. 1 in Annexure II and in accordance with Annexure III to the CLB Regulations, 1991. [*Reg. 42-A*] together with the following documents/particulars:—

1. Names and addresses of the officers of the company.
2. Full details of debenture holders such as names, addresses, amounts, rate of interest, dates of maturity and other terms and conditions of the debentures.
3. Reasons for non-payment or late payment.
4. Annual reports for the last three years.
5. Copy of the prospectus issued at the time of issue of debentures.
6. Copy of the trust deed.

Fee of Rs. 1000 is to be paid along with the petition in accordance in with CLB (Fees on Applications and Petitions) Rules, 1991, *Appendix* 6.

[1][**S. 117C. Liability of company to create security and debenture redemption reserve.**—(1) Where a company issues debentures after the commencement of this Act, it shall create a debenture redemption reserve for the redemption of such debentures, to which adequate amounts shall be credited, from out of its profits every year until such debentures are redeemed.

(2) The amounts credited to the debenture redemption reserve shall not be utilised by the company except for the purpose aforesaid.

(3) The company referred to in sub-section (1) shall pay interest and redeem the debentures in accordance with the terms and conditions of their issue.

(4) Where a company fails to redeem the debentures on the date of maturity, the [2][*Tribunal*] may, on the application[3] of any or all the holders of debentures shall, after hearing the parties concerned, direct, by order, the company to redeem the debentures forthwith by the payment of principal and interest due thereon.

(5) If default is made in complying with the order of the [2][*Tribunal*] under sub-section (4), every officer of the company who is in default, shall be punishable with imprisonment which may extend to three years and shall also be liable to a fine of not less than five hundred rupees for every day during which such default continues.]

NOTES

General Note : As and when the Companies (Second Amendment) Act, 2002 (11 of 2003) comes into force, the power under this section shall become transferred to the Tribunal to be exercised by it in place of the Company Law Board. The commentary should be read keeping this change in mind.

Companies (Amendment) Act, 2000

There was no mandatory provision in the Act for creating security for debenture-holders or for creating debenture redemption reserve. Further while the Act after its amendment in 1988 empowers the Company Law Board to order repayment of public deposits on failure on the part of the company, no such provision was made for repay-

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* For detailed procedure, see BHANDARI'S GUIDE TO COMPANY LAW PROCEDURES Vol. 1 (18th Edn.)

1. Ins. by the Companies (Amendment) Act, 2000, (53 of 2000) s. 48 (w.e.f. 13-12-2000).
2. **Subs. for "Company Law Board" by the Companies (Second Amendment) Act, 2002 (11 of 2003), s. 18.**
3. With a fee of Rs. 50/- under CLB (fees on Application & Petitions) Rules, 1991.

ment of the principal amount of debentures or interest thereon. Section 117C inserted by the Amendment Act, 2000 fills up this void. Earlier, clause 161 of the Companies Bill, 1993 and clause 105 of the Companies Bill, 1997 (which were not enacted) contained analogous provisions.

Notes on clause 161 of the Companies Bill, 1993 : "*Clause 161* is a new provision which seeks to make it obligatory for a company to create a security in favour of holders of debenture within three months from the date of issue of debentures. This will ensure speedy issue of debenture certificates to the debenture-holders. At present the Company Law Board has been vested with a power to extend time for issue of debentures certificates up to a period of nine months as provided in proviso to sub-section (1) of section 113 of the Act. It has now been made mandatory to create debenture redemption reserve to the extent of the value of the debentures including the amount of premium, if any, payable on the amount of debentures. The Act does not provide relief against non-payment of principal amount of debenture after maturity by the company. Further, the Act also does not provide any relief on non-payment of interest after due date. Debenture-holders can now approach Company Law Board in case of default by the company in payment of interest or principal amount. The non-compliance of the orders of the Company Law Board is punishable with imprisonment which may extend to three years and fine being not less than Rupees fifty for every day during which the default continues. It is hoped that the above measures will provide adequate protection for guarding the interest of the debenture-holders."

Notes on clause 105 of the Companies Bill, 1997 stated : "This section relates to liability of company to create security and debenture redemption reserve. This is new clause which prescribe the company to create a debenture redemption reserve out of its profits every year until such debentures are redeemed".

Companies (Second Amendment) Act, 2002 [11 of 2003]

The powers of Company Law Board under this section have been conferred on the Tribunal constituted under Part 1B of the Act. Consequential changes have accordingly been made in the section. Notes on Clauses of the Bill stated thus:

Notes on Clause.— This clause seeks to amend sections 111, 111A, 113, 117B, 117C and 118 of the Companies Act, 1956 relating to power to refuse registration of transfer of shares or interest of a Member or debentures and appeal against such refusal, rectification of register on transfer, limitation of time for issue of certificates, appointment of debenture trustees and duties of debenture trustees, liability of company to create security and debenture redemption reserve and right to obtain copies of and inspect trust deed. The Company Law Board has been conferred upon certain powers under these sections. It is proposed to confer these powers of the Company Law Board upon the Tribunal. These amendments are of consequential nature. (*Clause 14 of the Companies (Amendment) Bill, 2001*).

Scope of section

This section makes it obligatory for every company to issue only secured debentures. In other words, debentures which are not backed by security cannot be issued. The security is required to be created for issue of debentures, whether through prospectus or by rights issue or by way of private placement [sub-section (1)]. A charge is required to be created on the property(ies) of the company, which has to be filed with the Registrar within 30 days of the creation of the charge *vide* provisions of section 125 of the Act.

Creation of Debenture Redemption Reserve (DRR) by financial Institutions

DCA Circular No. 9/2002, dt. 18-4-2002.—One of the measures that the Central Government took to protect the interests of small investors in Companies Act was to insert Section 117C in the Companies (Amendment) Act, 2000 which contemplates the creation of security and liquidity to ensure timely repayment by companies on redemption of debentures and thereby afford protection to the debenture holders.

Section 117C requires every company to create a Debenture Redemption Reserve (DRR) to which 'adequate amounts' shall be credited out of its 'profits' every year until such debentures are redeemed, and shall utilize the same exclusively for redemption of a particular set or series of debentures only. Thus, the quantum of DRR to be created before the redemption liability actually arises in normal circumstances should be 'adequate' to pay the value of debentures plus accrued interest (if not already paid), till the debentures are redeemed and cancelled. Since the Section requires that the amount to be credited as DRR will be carved out of profits of the company only, there is no obligation on the part of the company to create DRR if there is no profit for the particular year.

The Department of Company Affairs (DCA) has received a number of representations from Public Financial Institutions, Non-Banking Financial Companies, Professionals, FICCI, CII, Chambers, etc. seeking clarifications in this regard.

The matter was considered keeping in view the purpose of the introduction of Section 117C and the genuine problems likely to be caused to the NBFCs, All India Financial Institutions (AIFIs) and banks that deal in financial products and would find it difficult to create DRR after transferring 20% of the profits to Reserve Fund out of the divisible profits as already required by RBI norms.

After taking into consideration the RBI directions/regulation on prudential norms applicable to banking companies, AIFIs and NBFCs, and the SEBI (Disclosure and Investor Protection), Guidelines, 2000, the Government hereby clarifies on adequate DRR and other related matters as under :-

(a) No DRR is required for debentures issued by All India Financial Institutions (AIFIs) regulated by Reserve Bank of India and Banking Companies for both public as well as privately placed debentures. For other FIs within the meaning of Section 4A, DRR will be as applicable to NBFCs registered with RBI.

(b) For NBFCs registered with the RBI under Section 45-IA of the RBI (Amendment) Act, 1997, 'the adequacy' of DRR will be 50% of the value of debentures issued through public issue as per present SEBI (Disclosure and Investor Protection) Guidelines 2000 and no DRR is required in the case of privately placed debentures.

(c) For manufacturing and infrastructure companies, the adequacy of DRR will be 50% of the value of debentures issued through public issue and 25% for privately placed debentures.

(d) Section 117C will apply to debentures issued and pending to be redeemed and as such DRR is required to be created for debentures issued prior to 13.12.2000 and pending redemption subject to clarifications issued herein.

(e) Section 117C will apply to non-convertible portion of debentures issued whether they are fully or partly convertible.

Housing Finance Companies.—II General Circular No. 4/2003, dt. 16-1-2003 [F. No. 6/3/2001-CLV].—For Housing Finance Companies registered with the National Housing Bank under Housing Finance Companies (NHB) Directions, 2001, "the adequacy" of Debenture Redemption Reserve (DRR) will be 50% of the value of debentures issued through public issues and no DRR is required in the case of privately placed debentures.

Creation and utilisation of DRR [Sub-sections (1) and (2)]

Every company is required to create, out of its profits debenture redemption reserve, equal to the value of debentures issued [Sub-section (1)]. This reserve is required to be utilised only for the repayment of debentures on their maturity, as per terms and conditions of issue of debentures, and it cannot be utilised for any other purpose. [Sub-section (2)].

Creation of Debenture Redemption Reserves (DRR) under SEBI Guidelines, 2000.—Chapter X of SEBI Guidelines, 2000 contain the Guidelines for Issue of Debt Instruments. The following provisions thereof relating to creation of DRR may be noted.

For the redemption of the debentures issued, the company shall create debenture redemption reserve in accordance with the provisions of the Companies Act, 1956. [*Clause 10.3.1*] [*Subs. by SEBI Circular No. 11, dt. 14-8-2003*].

Disclosure in offer document.—The offer document shall specifically state the assets on which security shall be created and shall also state the ranking of the charge/s. In case of second or residual charge or subordinated obligation, the offer document shall clearly state the risks associated with such subsequent charge. The relevant consent for creation of security such as *pari passu* letter, consent of the lessor of the land in case of leasehold

land, etc., shall be obtained and submitted to the debenture trustee before opening of issue of debenture [*Clause 10.6.1*].

The offer document shall state the security/asset cover to be maintained. The basis for computation of the security/asset cover, the valuation methods and periodicity of such valuation shall also be disclosed. The security/asset cover shall be arrived at after reduction of the liabilities having a first/prior charge, in case the debentures are secured by a second or subsequent charge.] [*Clause 10.6.2*].

Issue proceeds in escrow account

The issue proceeds shall be kept in an escrow account until the documents for creation of security as stated in the offer document, are executed. [*Clause 10.6.4*].

Filing of particulars of charge with the Registrar

If the issuing company proposes to create a charge for debentures of maturity of less than 18 months, it shall file with Registrar of Companies particulars of charge under the Companies Act [*Clause 10.6.5*].

Where no charge is to be created on such debentures, the issuer company shall ensure compliance with the provisions of the Companies (Acceptance of Deposits) Rules, 1975, as, unsecured debentures/bonds are treated as "deposits" for purposes of these rules. [*Clause 10.6.5 Proviso*].

The proposal to create a charge or otherwise in respect of such debentures, may be disclosed in the offer document along with its implications [*Clause 10.6.6*].

Responsibility of Merchant Banker.—The merchant banker shall, along with the draft offer document, file with the Board certificates from the bankers of the company that the assets on which the security is to be created are free from any encumbrances and the necessary permissions to mortgage the assets have been obtained or No-objection Certificate from the Financial Institutions or Banks for a second or *pari passu* charged in cases where assets are encumbered.

The merchant banker shall also ensure that the security created is adequate to ensure 100% asset cover for the debentures. [*Clause 10.2.5*] [*Subs. by SEBI Circular No. 11, dt. 14-8-2003*].

Redemption of debentures [Sub-section (3)]

Debentures should be redeemed in accordance with the terms and conditions of the issue/offer document. See also clause 10.5.1 of Chapter X of SEBI Guidelines, 2000.

Default in redemption—Petition before Company Law Board [Sub-section (4)]

In case of default in redeeming the debentures on the date of maturity, an application may be made by debenture holder(s) before the Company Law Board together with a fee of Rs. 50. After hearing the company and debenture holder, the CLB shall direct the company to redeem the debentures forthwith by payment of the principal amount and interest due thereon. In contrast, see section 58A(9) relating to default in the payment of deposit. It may be noted that under section 58A(9) the CLB may at its discretion, pass necessary orders directing the company to repay the deposits or part thereof or interest due therein forthwith, or within such time and subject to such direction as may be specified in order. The CLB may pass appropriate orders so as to safeguard the interest of the company, the depositors or public interest, in respect of any arrangements proposed by the company or repayment of deposits. On the other hand, under section 117C(4), once an application is made by a debenture holder, the CLB shall mandatorily pass order for redemption of the whole amount of debenture and interest due thereon. Under the extant provisions, no scheme of rescheduling can be considered by the CLB.

The provisions of the section were enforced with effect from 13-12-2000. The Company Law Board held that they are applicable also to those debentures which were issued before the effective date of the amendment. The section has a retrospective effect. On the failure of the company to redeem a debenture on its maturity, the debentureholder can

approach the CLB even if the debenture was issued at a date earlier to the amendment. *Deepak Jain v. Vijaya Leasing Ltd.*, (2002) 40 SCL 725 : (2003) 53 CLA 58 (CLB—Chennai).

Director disqualified on failure to redeem debentures on maturity [Sec. 274(1)(g)]

Clause (g) to sub-section (1) of section 274 has been inserted by the Companies Amendment Act, 2000. The effect of the amendment is that a director of a public company which has failed to redeem debentures on maturity and the default has continued for one year or more shall not be eligible for being appointed as a director in a public company. The disqualification lasts for a period of 5 years.

Disqualification of Directors under sec. 274(1)(g) Rules, 2003

§ For full text of the Rules, see *Appendix* 44 and Notes under section 274(1)(g), *post.*

Schedule XIII not applicable to defaulting company

A company which has made any default in repayment of debentures or interest thereon for a continuous period of 30 days in the preceding financial year before the date of appointment of its managerial personnel cannot avail of the dispensation under schedule XIII for payment of remuneration to such managerial personal in the event of loss or in adequacy of profits.

Penalty for default [Sub-section (5)]

The default for non-compliance of the orders of the Company Law Board is punishable under sub-section (5) with imprisonment upto 3 years and fine of not less than 500 rupees for each day of default.

Non-Compoundable offence.—The offence is not compoundable under section 621A.

ICSI Guidance Note on Compliance Certificate (August, 2003)

The ICSI has issued a Check List for issue of Compliance Certificate under proviso to Sec. 383A(1) in respect of the matters specified under Rule 3 of the Companies (Compliance Certificate) Rules, 2001. Paragraph 21 under Rule 3 relates to redemption of preference shares and debentures and reads as follows:

Paragraph 21.—**The company has redeemed ..... preference shares/debentures during the year after complying with the provisions of the Act.**

Prescribed Check List

Redemption of Debentures [*Item (b)*]

Check whether:

(i) the company has created a debenture redemption reserve for the redemption of debentures and credited adequate amount from out of the profits until such debentures are redeemed;

(ii) the company has not utilised the debenture reserve except for the redemption of debentures;

(iii) the company has paid interest and redeemed the debentures in accordance with the terms and conditions of their issue;

(iv) the company has complied with the order, if any, of the Company Law Board* with regard to redemption of debentures.

§ For the text of the Companies (Compliance Certificate) Rules, 2001, see *Appendix* 38.

§ For the full text of the Guidance Notes on Compliance Certificate and for Specimen Compliance Certificate Form as issued by ICSI see *Appendix* 312.

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* **Power transferred to National Company Law Tribunal from the commencement of Companies (Second Amendment) Act, 2002 (11 of 2003).**

S. 118. Right to obtain copies of and inspect trust deed.—(1) A copy of any trust deed for securing any issue of debentures shall be forwarded to the holder of any such debentures or any member of the company, at his request and within seven days of the making thereof, on payment—

(a) in the case of a printed trust deed, of [1][such sum as may be prescribed[2]]; and

(b) in the case of a trust deed which has not been printed, of [3][such sum as may be prescribed[4]] for every one hundred words or fractional part thereof required to be copied.

(2) If a copy is refused, or is not forwarded within the time specified in sub-section (1), the company, and every officer of the company who is in default, shall be punishable, for each offence, with fine which may extend to [5][five hundred rupees] and with a further fine which may extend to [6][two hundred rupees] for every day during which the offence continues.

(3) The [7][*Central Government*] may also, by order[8], direct that the copy required shall forthwith be sent to the person requiring it.

(4) The trust deed referred to in sub-section (1) shall also be open to inspection by any member or debenture-holder of the company in the same manner, to the same extent, and on payment of the same fees, as if it were the register of members of the company.

NOTES

Eng. Act, 1948 : Sec. 87 Previous Act : Sec. 125
Eng. Act, 1985 : Sec. 191

General Note : As and when the Companies (Second Amendment) Act, 2002 (11 of 2003) comes into force, the power under this section shall become transferred to the Central Government to be exercised by it in place of the Company Law Board. The commentary should be read keeping this change in mind.

Companies (Amendment) Act of 1988

Earlier, sub-section (1) provided for a fee of Rupee one (in case of printed copy) and six annas (in case the copy is not a printed one) for securing copy of trust deed. As per Amendment Act of 1988, the fee will now be prescribed by the Central Government.

The powers of the Court under sub-section (3) have been conferred on the Company Law Board with effect from 31-5-1991.

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1. Subs. by the Companies (Amendment) Act, 1988, for the words "the sum of one rupee", s. 67 w.e.f. 15-7-1988 *vide* GSR No. 781(E) dated 13-7-1988.
2. The prescribed fee is Rs. Ten *vide* GSR 782(E), dt. 13-7-1988 under Rule 21A of Companies (Central Govt.'s) General Rules & Forms inserted w.e.f. 15-7-1988.
3. Subs. by the Companies (Amendment) Act, 1988, for the words "six annas", s. 67 w.e.f. 15-7-1988.
4. The prescribed fee is Re. One *vide* GSR 782(E), dt. 13-7-1988 under Rule 21A of Companies (Central Govt.'s) General Rules & Forms, 1956 inserted w.e.f. 15-7-1988.
5. The words "fifty rupees" substituted by the Companies (Amendment) Act, 2000, (53 of 2000) s. 49 (w.e.f. 13-12-2000).
6. The words "twenty rupees" substituted by the Companies (Amendment) Act, 2000, (53 of 2000) s. 49 (w.e.f. 13-12-2000).
7. **Subs. for "Company Law Board" by the Companies (Second Amendment) Act, 2002 (11 of 2003), s. 19. Earlier subs. by the Companies (Amendment) Act, 1988, (w.e.f. 31-5-1991) *vide* GSR dated 31-5- 1991, for the word "Court".**
8. Application for such order to be made under CLB Regulations, 1991 accompanied by fee of Rs. 50/- under CLB (Fees on Applications & Petitions) Rules, 1991, see *Appendix* 6.

Companies (Amendment) Act, 2000

Penalty enhanced.—The Amendment Act of 2000 enhanced the penalty amount:

(1) from 50 rupees to 500 rupees under sub-section (2).

(2) from 20 rupees to 200 rupees under sub-section (2).

for every day during which the offence continues.

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*]

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*]

Companies (Second Amendment) Act, 2002 [11 of 2003]

The powers of Company Law Board under this section have been conferred on the Central Government. Consequential changes have accordingly been made in the section. As per the Bill, the powers of CLB were initially proposed to be transferred to the Tribunal. Notes on Clauses of the Bill stated thus:

Notes on Clause.— This clause seeks to amend sections 111, 111A, 113, 117B, 117C and 118 of the Companies Act, 1956 relating to power to refuse registration of transfer of shares or interest of a Member or debentures and appeal against such refusal, rectification of register on transfer, limitation of time for issue of certificates, appointment of debenture trustees and duties of debenture trustees, liability of company to create security and debenture redemption reserve and right to obtain copies of and inspect trust deed. The Company Law Board has been conferred upon certain powers under these sections. It is proposed to confer these powers of the Company Law Board upon the Tribunal. These amendments are of consequential nature. (*Clause* 14 of the Companies (Amendment) Bill, 2001).

Fees for copy of trust deed

The fee payable in pursuance of the following provisions of the Act, which is now prescribed is:

(1) Clause (a) of sub-section (1) of section 118 ...Rupees ten.

(2) Clause (b) of sub-section (1) of section 118 ...Rupee one.

[See Rule 21A of the Companies (Central Government's) General Rules and Forms, 1956, at *Appendix* 1].

Debenture trustees

Debenture trustees are governed by the SEBI (Debenture Trustees) Rules, 1993 and SEBI (Debenture Trustees) Regulations, 1993

SEBI Debenture Trustees Rules, 1993.—The SEBI (Debenture Trustees) Rules, 1993 provide for the following matters:—

1. Registration of debenture trustees
2. Conditions for grant or renewal of certificates to debenture trustees
3. Period of validity of certificate.

§ For text of the Rules, see *Appendix* 217.

SEBI (Debenture Trustees) Regulations, 1993.—The SEBI (Debenture Trustees) Regulations, 1993 provide for the following matters:—

1. Procedure for registration of debenture trustees and renewal of registration
2. Responsibilities and obligations of debenture trustees
3. Inspection of books of accounts and other records of the debenture trustees by SEBI
4. Procedure for action by SEBI in case of default by debenture trustees.

The Schedule to the Regulations, 1993 deal with the following matters:—

Schedule I Part A—Application Form for registration as debenture trustee.

Schedule I Part B—Certificate for registration granted to debenture trustees.

Schedule II—Fees payable by debenture trustees.

Schedule III—Code of conduct for debenture trustees.

Schedule IV—Contents of debenture trust deed.

§ For text of the Regulations, see *Appendix* 218.

Meetings of debenture-holders for variation of rights

The trust deed usually contains provision for the holding of meetings and empowering a two-thirds or three-fourths majority to approve variations of the rights in good faith for the benefit of the general body of debenture-holders as a whole.

A debenture deed sometimes contain a clause that the rights of the debenture-holders may be modified with the consent of a majority of (*e.g.*,) three-fourths of them, and that this consent shall bind all the debenture-holders. *Sneath v. Valley Gold Co. Ltd.*, (1893) 1 Ch 477. The modification may provide for postponement of payment of principal or of interest, *Northern Assurance Co. Ltd. v. Farnham United Breweries Ltd.*, (1912) 2 Ch 125, where redeemable debentures were made "irredeemable" or for any other alteration of the rights of the debenture-holders, provided it is not unfair or oppressive, *Goodfellow v. Nelson Line (Liverpool) Ltd.*, (1912) 2 Ch 324 (alteration upheld); *Re New York Taxi-Cab Co., Ltd., Sequin v. New York Taxi-Cab Co. Ltd.*, (1913) 1 Ch 1 (alteration held invalid), or obtained by a bribe or a special advantage given to some of the debenture-holders. *British American Nickel Corporation v. O'Brien*, (1927) AC 369. There is a general principle applicable to all authorities conferred on majorities of classes enabling them to bind minorities, namely, that the power must be exercised for the purpose of benefitting the class as a whole and not merely individual members only. Per VISCOUNT HALDANE (*ibid*) (at p. 371).

Accordingly the terms of the power must be very carefully considered. A power to release the mortgaged premises does not include a power to release the company. The power to modify the rights of the debenture-holders against the company does not include a power to relinquish all their rights. A power to compromise their rights presupposes some dispute about them or difficulties in enforcing them and does not include a power to exchange their debentures for shares in another company where there is no such dispute or difficulty. A power to compromise does not include a power to make presents. *Mercantile Investment and General Trust Co. v. River Plate Loan Co.*, (1894) 1 Ch 578; *Sneath v. Valley Gold Co.*, (1893) 1 Ch 477 (CA); *Mercantile Investment and General Trust Co. v. International Co. of Mexico*, (1893) 1 Ch 484 (CA); *Walker v. Elmore's German Metal Co.*, (1901) 85 LT 767 (CA).

A power to compromise will not authorise every kind of variation because compromise involves some real disputes or difficulty. Difficulty in obtaining payment may justify a modification which will have the effect of improving the prospects. (*ibid*). The power may be used to sanction any arrangement giving shares in a company in exchange for debentures or the creation of a mortgage ranking in priority to the debentures, *Thornton v.*

Hutchinson & Sons, (1915) 31 TLR 324; *Follit v. Eddystone Granite Quarries,* (1892) 3 Ch 75.

An authority to make any modification or arrangement gives wider power than the word compromise. Under the exercise of this power the time for redeeming terminable debentures may be extended or they may be made perpetual and that too for the convenience of the company provided that debenture-holders get some equivalent advantage. *Mercantile Investment and General Trust Co. v. International Co. of Mexico,* (1893) 1 Ch 484 (CA); *Northern Assurance Co. v. Farnham United Breweries,* (1912) 2 Ch 125; *Re, Joseph Stocks & Co.,* (1912) 2 Ch 134; *Re, Shandon Hydropathic Co.,* 1911 SC 1153.

The majority of the debenture-holders in the exercise of this power cannot authorise the company to sell the assets charged and to divide the proceeds not rateably among all the debenture-holders, but among only those willing to accept the lowest price for their debentures. *New York Taxi Cab Co., Re,* (1913) 1 Ch 1. In the absence of a power to compromise, the same can be effected with the sanction of the court under section 391. At a meeting of debenture-holders voting goes by the face value of the debentures and not by the issue value. *Kent Collieries, Re,* (1907) 23 TLR 559.

Notice of meetings by company to debenture holders.—If the debenture trust deed contains no provision how debenture-holders are to be informed of a meeting, notice by advertisement will be sufficient and shall be deemed to have been given on the day of the advertisement. *Sneath v. Valley Gold Co.,* (1893) 1 Ch 477 (CA); *Mercantile Investment and General Trust Co. v. International Co. of Mexico,* (1891) cited (1893) 1 Ch 484n at 489n (CA).

Debentureholders with special interest.—Where a debenture-holder is also holding some other position, *e.g.*, that of a shareholder in the company and therefore he occupies a special position, he may vote according to his special interest even if it conflicts with the interest of other debenture-holders. Such special interest may also arise by virtue of the fact that a debenture-holder has been granted some special advantages within the knowledge of the other debenture-holders. *Goodfellow v. Nelson Line,* (1912) 2 Ch 324. But even so he has to keep in mind the interest of the class as a whole and therefore if his voting was influenced by some secret consideration it would nullify the resolution. *British America Nickel Corpn. v. Brien,* (1927) AC 369 (PC).

Release of sureties.—Sureties for debenture-holders are not automatically released by virtue of the exercise of the power of compromise or reconstruction unless they are expressly released as a part of the compromise or the reconstruction. *Finlay v. Mexican Investments Co.,* (1897) 1 QB 517; *Andrew v. Macklin,* (1886) 6 B&S 201; *Ellis v. Wilmot,* (1874) LR 10 Ex 10; *Re, London Chartered Bank of Australia,* (1893) 3 Ch 540; *Dane v. Mortgage Insurance Co.,* (1894) 1 QB 54 (CA); *Re, Garner's Motors,* (1937) Ch 594; *Shaw v. Royce,* (1911) 1 Ch 138.

Inspection of trust deed [sub-section (4)]

A right to inspect the trust deed or ask for a copy to be furnished on payment was, under the previous Act, confined to holders of debentures only, but under the present section the right is extended to any member of the company.

A time-limit of seven days is fixed for compliance with a request for a copy.

Under the English Act any third party is also entitled to a copy on payment.

The right of inspection of the Register and Index of Debenture-holders and Register and Index of Members is allowed under section 163.

Foreign companies.—This section also applies to foreign companies. See Notes under section 600.

Penalty for default [sub-section (2)]

A holder of debentures or any member of the company has a right to inspect the trust deed or ask for a copy of it to be furnished on payment. If a copy is refused or is not forwarded within the time specified, the company and every officer of the company who is in default shall be punishable for each offence, with fine up to Rs. 500, and with a further fine up to Rs. 200 for every day of default.

Stamp duty

Debenture requires impressed stamp and the stamp is payable on a graduated scale as provided in Article 27 of the Indian Stamp Act, 1899. For the recent amendments made in Article 27 of the Indian Stamp Act, 1899 reducing the stamp duty by almost 50%. See Notfn. No. S.O. 130(E), dt. 28-1-2004 (w.e.f. 1-3-2004) issued by the Deptt. of Revenue. For Schedule of stamps refer K. KRISHNAMURTHY'S INDIAN STAMP ACT, 8th Edn., 2002.

Petition before CLB

Petition for furnishing copy of trust deed under sub-section (3) be filed before the Regional Bench of CLB in Form No. 1 of Annexure II to the CLB Regulations, 1991 with a fee of Rs. 50/- and accompanied by the following documents:

(1) Copy of the letter written to the company for the issue of trust deed.
(2) Copy of the letter of refusal, if any, issued by the company.
(3) Affidavit verifying the petition.
(4) Bank draft evidencing payment of application fee.
(5) Memorandum of appearance in Form No. 5 of Annexure I with a copy of the Board's resolution or the executed Vakalatnama, as the case may be.

§ For text of the Company Law Board Regulations, 1991, refer *Appendix* 3.

Secretarial Practice Notes : Inspection of trust deed

(a) Whether any member/debenture-holder sought copy of the trust deed in respect of debentures? If so, whether the request had been complied with within 7 days on requisite payment?
(b) Check whether CLB Order, if any, regarding supply of copy of the trust deed had been complied with?

Documents Involved: 1. Debenture Trust Deed, 2. Correspondence regarding Debenture Trust Deed, 3. Order, if any of the Company Law Board.

S. 119. Liability of trustees for debenture-holders.—(1) Subject to the provisions of this section, any provision contained in a trust deed for securing an issue of debentures, or in any contract with the holders of debentures secured by a trust deed, shall be void in so far as it would have the effect of exempting a trustee thereof from, or indemnifying him against, liability for breach of trust, where he fails to show the degree of care and diligence required of him as trustee, having regard to the provisions of the trust deed conferring on him any powers, authorities or discretions.

(2) Sub-section (1) shall not invalidate—

(a) any release otherwise validly given in respect of anything done or omitted to be done by a trustee before the giving of the release; or
(b) any provision enabling such a release to be given—
    (i) on the agreement thereto of a majority of not less than three-fourths in value of the debenture-holders present and voting in

person or, where proxies are permitted, by proxy, at a meeting summoned for the purpose; and

(ii) either with respect to specific acts or omissions or on the trustee dying or ceasing to act.

(3) Sub-section (1) shall not operate—

(a) to invalidate any provision in force at the commencement of this Act so long as any person then entitled to the benefit of that provision or afterwards given the benefit thereof under sub-section (4) remains a trustee of the deed in question; or

(b) to deprive any person of any exemption or right to be indemnified in respect of anything done or omitted to be done by him while any such provision was in force.

(4) While any trustee of a trust deed remains entitled to the benefit of a provision saved by sub-section (3), the benefit of that provision may be given either—

(a) to all trustees of the deed, present and future; or

(b) to any named trustees or proposed trustees thereof;

by a resolution passed by a majority of not less than three-fourths in value of the debenture-holders present in person or, where proxies are permitted, by proxy, at a meeting called for the purpose in accordance with the provisions of the deed or, if the deed makes no provision for calling meetings, at a meeting called for the purpose in any manner approved by the Court.

NOTES

Eng. Act, 1948 : Sec. 88
Eng. Act, 1985 : Sec. 192

Companies Act, 1956

Liability of trustee for debenture-holder.—This section is new. Under the 1913 Act, there was no statutory provision making the trustee of a trust deed for debenture-holders liable for breach of trust. But this section of the present Act enacts a statutory provision making void all clauses in a trust deed exempting the trustee from such liability. Hereafter, a release from liability can be given only when a majority of not less than three-fourths in value of the debenture-holders present in person or by proxy agree at a meeting summoned for the purpose, and the voting must relate to specific acts or omission or to a trustee who is dead or has ceased to act.

The section does not affect any term in trust deeds existing at the commencement of this Act or any exemption already accrued before such commencement.

Committee's view on liability.—The Company Law Committee on whose recommendation the section was adopted explained the position as follows : "The other point about debentures on which we should like to comment is the liability of trustee for debenture-holders. There is no provision in the Indian Companies Act similar to section 88 of the English Act. Both the Cohen Committee and the Millin Commission in South Africa recommended the adoption of the provisions embodied in this section of the English Act. The effect of this section is that a general provision in any trust deed exempting the trustees for debenture-holders from liability is rendered void, but 'enabling' clauses as distinct from 'indemnity' clauses are permitted. This section does not affect the right of existing trustees, who retain whatever rights of indemnity they enjoyed before the Act, but prohibits the general exemption or indemnity in regard to new appointments. This provi-

sion in the English Act was designed to present the common practice, under which most trustees for debenture-holders were appointed under trust deeds containing the clause which absolved trustees from liability for anything but their wilful neglect or default. Trustees for debenture-holders should show the same degree of care and diligence in administering debenture trusts as are required of other trustees and we see no reason why they should be permitted to escape their liability where they do not do so. We, therefore, recommend that a new section on the lines of section 88 of the English Act should be incorporated in the Indian Companies Act". (*Report* : Para 228).

Companies (Amendment) Act, 2000

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*]

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*]

Scope of section

It has been the general practice to insert clauses in debenture trust deeds absolving every trustee from liability for anything but his fraud or wilful neglect. As trustees for debenture-holders receive remuneration for their services, there is no reason why they should be allowed to escape liability for failure to do their duty properly. It was the recommendation of the Cohen Committee (*Report* : para 64), "that a general provision for exempting trustees from liability should be prohibited but that enabling clauses as distinct from indemnity clauses, should be permitted". The section gives effect to this recommendation which was approved by the Indian Company Law Committee.

§ Also refer to notes under sections 117A, 117B and 117C inserted by the Companies (Amendment) Act, 2000.

Whether the debenture trustees have the right to carry on the business or not must primarily depend on the trust deed. The business carried on by the trustees still remains the business of the company. It does not become the business of the debenture-holders. The debenture trustees are liable to account to the company as mortgagees in possession but they are not the trustees of the company. *L.V. Apte v. R.G.N. Price,* (1963) 33 Com Cases 966, 984, 990, 993 : AIR 1962 AP 274.

Remuneration of trustees

The trust deed should contain an express provision about trustees' remuneration. The remuneration may be made payable out of the mortgaged property or out of the proceeds of sale by the trustees or as per terms of the trust deed the remuneration could also be borne by the company. The date to which the remuneration is payable will be determined by the terms of the deed which should also give a guidance as to the trustees' remuneration after the appointment of a receiver. *Re, Piccadilly Hotel,* (1911) 2 Ch 534; *Re, Locke & Smith,* (1914) 1 Ch 687 (CA); *Re, Anglo-Canadian Lands,* (1918) 2 Ch 287; *Re, British Consolidated Oil Corporation,* (1919) 2 Ch 81. It is usual to add that the remuneration of the trustee shall be a first charge on the assets. *Piccadilly's* case, (*Supra*).

Powers and duties of trustees

Since trustees are constituted into legal mortgagees of the property charged, they can exercise all the powers of mortgagees. Thus where some shares form a part of the secu-

rity and are registered in the names of trustees, they can exercise voting power free from control by the company even if there are no arrears or defaults as to interest. *Siemens Brothers & Co. v. Burns,* (1918) 2 Ch 324 (CA). Titled deeds of the property charged will be normally in the custody of trustees. *Fisher v. Ind Coope,* (1909) 26 TLR 11 (CA).

The trust deed often provides for the creation of a sinking fund out of which to redeem the debentures from time to time. If it is intended that the interest on the redeemed debentures should be added to the sinking fund, this must be expressly stated, for it will not be inferred. *Morrison v. Chicago and North-West Granaries Co.,* (1898) 1 Ch 263. If the sinking fund is to be applied in the redemption of debentures by purchase, the trustees' duty is to use it to the best advantage of all concerned: they are not bound to accept the lowest tenders if by accepting an offer of a larger block for sale they can effect a more beneficial redemption. *National Trust Co. v. Wicher,* (1912) AC 377 (PC); PALMER'S COMPANY PRECEDENTS, 378 [15th Edn., Vol. 3 (Debentures)]. The trust deed usually declares that the principal money shall become payable in certain events, including the event of the company committing any breach of the covenants contained in the deed. This does not, however, give each debenture-holder a right to assert that the principal is payable because of some trivial default. *Re, Melbourne Brewery and Distillery,* (1901) 1 Ch 453.

Power is sometimes given to the trustees to settle disputed questions. In such a case an exercise of their discretion is valid. *Re, Noakes v. Noakes & Co.,* (1907) 1 Ch 64. There have been several cases determining the manner in which, under the particular terms of a trust deed, the trustees are to deal with compensation money received on the refusal of the renewal of a licence attached to a part of the mortgaged property. Generally, the money received will be treated as money received upon a sale. If the trustees have a power of sale before the security is enforceable, the moneys received must be treated as if they arose on such a sale. *Noakes v. Noakes & Co., (Supra); Re, Bentley's Yorkshire Breweries,* (1909) 2 Ch 609; *Dawson v. Braime's Tadcaster Brewery,* (1907) 2 Ch 359. If neither the trustees nor the company have power to deal with the mortgaged assets, the money, it seems, must be paid to the trustees and invested, the company receiving the income. *Law Guarantee Society v. Mitcham Brewery,* (1906) 2 Ch 98. See GORE BROWNE ON COMPANIES, 17.17.2 (44th Edn., 1987).

§ Also refer Notes under S. 117.

Release of trustee from liability [Sub-section (2)(b)]

For a valid release under this clause, both the requirements of sub-clauses (i) and (ii) should be complied with; that is, not only should a majority of three-fourths in value of the debenture-holders agree but also the release must relate to specific acts or omissions and not be a provision for general release.

Debenture-trustee and relief from liability.—A debenture trustee has been held to be not an officer of the company and therefore he is not entitled to seek relief under s. 633(2) against any apprehended proceedings for negligence, breach of trust, *etc.* The court conceded only to this proposition that if an officer of the company has been appointed by the company as a trustee for its debentureholders, he may qualify for relief under s. 633. *Central Bank Executor & Trustee Co. Ltd. v. Magna Hard Temp Ltd.,* (1997) 89 Com Cases 40 (AP).

Court [Sub-section (4)]

'Court' means the High Court as stated in section 10.

Secretarial Practice Notes : Liability of trustees for debenture-holders

Check that the trust deed did not provide for indemnification/exemption to the trustees from liability, breach of trust *etc.* except in accordance with the provisions of this section.

Documents Involved: 1. Debenture Trust Deed, 2. Minutes of Meeting of Debenture-holders.

S. 120. Perpetual debentures.—A condition contained in any debentures or in any deed for securing any debentures, whether issued or executed before or after the commencement of this Act, shall not be invalid by reason only that thereby, the debentures are made irredeemable or redeemable only on the happening of a contingency, however remote, or on the expiration of a period, however long.

NOTES

Eng. Act, 1948 : Sec. 89
Eng. Act, 1985 : Sec. 193

Previous Act : Sec. 126

Companies (Amendment) Act, 2000

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*Vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non payment of dividend has been vested in SEBI. [*vide section 209A*]

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*]

"Irredeemable" Debentures

A debenture will be treated as irredeemable where either there is no period fixed for repayment of the principal amount or repayment of it is made conditional on the happening of an event which may not happen for an indefinite period or may happen only in certain specified and contingent events, *e.g.*, the winding up of the company or the company giving notice to redeem.

In its application to debentures the word 'irredeemable' *prima facie* means that the company has no power to redeem or pay them off, but it is frequently used with the intention of describing debentures of which the holder cannot demand repayment, even though the company may at its option redeem them. The context may be sufficient to establish this latter meaning; *Willey v. Joseph Stocks & Co.*, (1912) 2 Ch 134. But it is not proper in such a case to use the word 'irredeemable', and 'perpetual' should be more true. Stock which is expressed to be 'redeemable at the option of the company' is not repayable on the demand of the holder. *Edinburgh Corpn. v. British Linen Bank*, (1913) AC 133 (HL).

Not a clog on equity of redemption.—As the definition of a 'debenture' is such as to include a mortgage, a perpetual mortgage in the nature of a debenture issued by a company is valid under this section, though it will, as a mortgage be invalid under the Transfer of Property Act, on the ground that it is a clog on the equity of redemption. See *Knightsbridge Estates Trust Ltd. v. Byrne*, (1940) 2 All ER 401. This is a special characteristic of irredeemable debentures. 'Irredeemable' may mean, if the context so requires, 'not liable to be called in', as well as 'such that the company cannot claim to redeem the stock'. *Willey v. Joseph Stocks & Co.*, (1912) 2 Ch 134.

One of the effects of a secured debenture which is irredeemable is that if the company is not permitted to redeem the security by paying back to debenture-holder, the term putting this prohibition upon the company shall be void as a clog on the equity of redemption and therefore notwithstanding the term against redemption, the company may choose to pay back debenture-holder. After some doubts it was finally held in *Kreglinger v. New Patagonia Meat and Cold Storage Co. Ltd.*, (1914) AC 25 (HL) that the doctrine of clog

on redemption would be equally applicable to a floating charge also. Hence where the debenture even if it is perpetual, if it creates a charge on the company's property, company can pay back the debenture-holder and redeem its property. In such cases lender can protect himself in the way suggested by the House of Lords that some collateral advantage may be reserved not only during the currency of the loan but even after repayment provided that the arrangement is perfectly fair and business like transaction. *Kreglingers* case, (*Supra*). Accordingly where the terms of the debentures stipulated that in the event of company's winding up the debentureholders would be entitled to one-third of the company's surplus assets. The term was held to be enforceable although the debentures had been in the meantime paid off and extinguished. *Cuban Land Co., Re,* (1921) 2 Ch 147. Where, however, a share of profits (in addition to interest at 10 per cent per annum) was to be paid on each debenture until a bonus of 100 per cent had been paid, the bonus was held to be a clog on the equity of redemption and ceased to be payable after the principal sum and interest had been paid off. *Re, Rainbow Syndicate Ltd.,* (1916) WN 178. The debenture-holder had in this case taken proceedings to enforce payment of the debenture. See further, as to clogging, *Salt v. Marquess of Northampton,* (1892) AC 1; *Bradley v. Carritt,* (1903) AC 253; *Browne v. Ryan,* (1901) 2 IR 671; *Samuel v. Jarrah Timber and Wood Paving Corpn.,* (1904) AC 323; *De Beers Consolidated Mines v. British South Africa Co.,* (1912) AC 52; and *Cuban Land and Development Co.,* (1921) 2 Ch 147 (where debenture-holders had a right to share in surplus assets on a winding up).

Redemption of debentures

Debentures may be for a fixed term of year, or they may be repayable on demand or on notice or even be irredeemable. The date when or the circumstances in which the debentures are to be repaid are generally stated in the debenture itself or in the trust deed and on the date or happening of the circumstances so specified the company becomes liable to pay the principal amount to the debenture-holder. A company may purchase its own debentures which then become extinguished but as stated in the succeeding section they are capable of being reissued. If the company purchases its own debentures for an amount less than the face value, the difference constitutes a profit in the shape of a capital gains. *Wall v. London & Provincial Trust,* per YOUNGER J. (1920) 1 Ch 45; per SARGANT J. (1920) 2 Ch 582.

In all cases of debentures, whatever be the express term, the principal amount becomes payable upon the commencement of company's winding up. *Wallace v. Universal Automatic Co.,* (1894) 2 Ch 547 (CA). If the debenture carries floating charge the charge crystallises on the commencement of winding up and attaches to the property covered by the charge. *Re, Panama, etc. Mail Co.,* (1870) 5 Ch App 318; *Re, Colonial Trusts Corporation,* (1879) 15 Ch D 465; *Wallace v. Universal Automatic Machines Co.,* (1894) 2 Ch 547 (CA). The right of debentureholders to enforce their security also arises when the company parts with the whole or substantially the whole of its undertaking and ceases to be a going concern. *Hubbuck v. Helms,* (1887) 56 LJ Ch 536. This does not cover the normal turnover of the company's assets in the ordinary course of its business, *Re, Borax Co.,* (1901) 1 Ch 326 (CA); *Re, H.H. Vivian & Co.,* (1900) 2 Ch 654.

When a debenture is payable after a specified date the holder should on the passing of that date give notice calling upon the company to pay him. It is then that the debenture becomes presently payable.

Company Law Board's power to order redemption [Sec. 117C(4)

CLB has been empowered under sub-section (4) of section 117C to direct the company to redeem the matured debentures forthwith.

S. 121. Power to re-issue redeemed debentures in certain cases.—(1) Where either before or after the commencement of this Act, a company has redeemed any debentures previously issued, then,—

(a) unless any provision to the contrary, whether express or implied, is contained in the articles, or in the conditions of issue, or in any contract entered into by the company; or

(b) unless the company has, by passing a resolution to that effect or by some other act, manifested its intention that the debentures shall be cancelled;

the company shall have, and shall be deemed always to have had, the right to keep the debentures alive for the purposes of re-issue; and in exercising such a right, the company shall have, and shall be deemed always to have had, power to re-issue the debentures either by re-issuing the same debentures or by issuing other debentures in their place.

(2) Upon such re-issue, the person entitled to the debentures shall have, and shall be deemed always to have had, the same rights and priorities as if the debentures had never been redeemed.

(3) Where with the object of keeping debentures alive for the purpose of re-issue, they have, either before or after the commencement of this Act, been transferred to a nominee of the company, a transfer from that nominee shall be deemed to be a re-issue for the purposes of this section.

(4) Where a company has, either before or after the commencement of this Act, deposited any of its debentures to secure advance from time to time on current account or otherwise, the debentures shall not be deemed to have been redeemed by reason only of the account of the company having ceased to be in debit whilst the debentures remained so deposited.

(5) The re-issue of a debenture or the issue of another debenture in its place under the power by this section given to, or deemed to have been possessed by, a company, whether the re-issue or issue was made before or after the commencement of this Act, shall be treated as the issue of a new debenture for the purposes of stamp duty, but it shall not be so treated for the purposes of any provision limiting the amount or number of debentures to be issued:

Provided that any person lending money on the security of a debenture re-issued under this section which appears to be duly stamped may give the debenture in evidence in any proceedings for enforcing his security without payment of the stamp duty or any penalty in respect thereof, unless he had notice or, but for his negligence, might have discovered, that the debenture was not duly stamped; but in any such case the company shall be liable to pay the proper stamp duty and penalty.

(6) Nothing in this section shall prejudice—

(a) the operation of any decree or order of a Court of competent jurisdiction pronounced or made before the twenty-fifth day of February, 1910, as between the parties to the proceedings in which the decree or order was made;

(b) where an appeal has been preferred against any such decree or order, the operation of any decree or order passed on such appeal, as between the parties to such appeal; or

(c) any power to issue debentures in the place of any debentures paid off or otherwise satisfied or extinguished, reserved to a company by its debentures or the securities for the same.

NOTES

Eng. Act, 1948 : Sec. 90
Eng. Act, 1985 : Sec. 194

Previous Act : Sec. 127

'Court' in sub-section (6)(a) means any Court and not the High Court only as defined in section 10.

Companies (Amendment) Act, 2000

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*]

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*]

Reissue of debentures

The advantage of keeping debentures, which have been issued, alive is that the preliminaries preceding the issue of the debentures need not be complied with again and the re-issue can be made without delay.

When such debentures are re-issued, no report of satisfaction of the charge has to be filed with the Registrar of Companies, and no fresh mortgage has to be created. Sub-section (5) provides that the re-issue shall require stamp-duty in the same way as a fresh issue of debentures, but the company does dispense with the stamp duty on creation of a mortgage.

Another advantage of reissuing is that the person entitled to the debenture shall be deemed to have in the same priorities as if the debentures had never been redeemed, thus keeping the rights to be treated as a part of the same issue and not postponed to the second mortgage debentures issued in the meantime. *Fitzgerald v. Perse,* (1908) 1 Irish Reports 279.

The power to re-issue debentures does not authorise the issue in the place of the redeemed debentures, of debentures different in their terms from those which have been redeemed. *Antofagasta, etc., Rly. Co. Trust Deed v. Schroder & Ors.,* (1939) 2 All ER 461 : (1939) 9 Com Cases 313 (Ch D).

Transfer of registered debentures

§ For transfer of debentures by registered holders, see Notes under Section 108, *ante.*

Debentures to bearer

§ For various kinds of debentures including debentures to bearer, see Notes under Section 2(12), *ante.*

Balance-sheet to disclose debentures redeemed which can be re-issued

As per Note (J) of Part I of Schedule VI, the Balance-sheet of the company should state the particulars of redeemed debentures which the company has power to re-issue.

Stamp duty on re-issue of debentures secured by registered mortgage

Since under Article 27 of Schedule 1 of the Indian Stamp Act, 1899, debentures secured by registered mortgage are exempted from Stamp Duty, the question of Stamp duty does not arise when the same debentures are re-issued and they are still secured by the same registered mortgage.

Secretarial Practice Notes : Power to re-issue redeemed debentures

Whether the company had re-issued the redeemed debentures? If so, check that articles/conditions of issue/contract/general meeting resolution were not restricting such re-issue.

Documents Involved: 1. Articles, 2. Prospectus, 3. Minutes of Board/Committee/ General Meeting, 4. Register of Debentureholders.

S. 122. Specific performance of contract to subscribe for debentures.—A contract with a company to take up and pay for any debentures of the company may be enforced by a decree for specific performance.

NOTES

Eng. Act, 1948 : Sec. 92
Eng. Act, 1985 : Sec. 195

Previous Act : Sec. 128

Companies (Amendment) Act, 2000

Provisions to be administered by SEBI.—The provisions of this section are to be administered by SEBI in respect of companies already listed or companies which intend to get listed. In respect of other companies, the administration shall be by the Central Government. [*vide section 55A*].

Inspection of books of account and other books and papers.—In the case of listed public companies and companies which intend to get listed, the power to inspect books of account and other books and papers in respect of issue and transfer of securities and non-payment of dividend has been vested in SEBI. [*vide section 209A*]

SEBI authorised to file complaints under section 621.—Section 621 has been amended for authorising SEBI to file complaints for offences relating to issue and transfer of securities and non-payment of dividend. [*vide section 621*]

Scope of section

This section provides that a contract to subscribe for debentures will be specifically enforced. In the absence of a special provision like this, a mere agreement to lend money on a particular security will not be specifically enforceable. *Cf. Sewa Singh v. Milkha Singh,* AIR 1936 Lah 727; *South African Territories Ltd. v. Wallington,* (1898) AC 309.

Normally a decree for specific performance of a contract will not be passed by the Court, if the party injured by the breach of it can be adequately compensated by damages. The provisions of this section are an exception to that rule. In the case of a breach of contract to take up debentures, damage arising from the breach is difficult to prove.

Forfeiture of debenture

Where payment for debentures is to be by instalments and on the debenture-holders failure to pay an instalment, the company has declared his debenture to be forfeited, the debenture will cease to be specifically enforceable. *Kuala Pahi Rubber Estates v. Mowbray,* (1914) 111 LT 1072.

S. 123. Payments of certain debts out of assets subject to floating charge in priority to claims under the charge.—(1) Where either—

(a) a receiver is appointed on behalf of the holders of any debentures of a company secured by a floating charge; or

(b) possession is taken by or on behalf of those debenture-holders of any property comprised in or subject to the charge;

then, if the company is not at the time in course of being wound up, the debts which in every winding up are, under the provisions of Part VII relating to preferential payments, to be paid in priority to all other debts, shall be paid forthwith out of any assets coming to the hands of the receiver or other person taking possession as aforesaid in priority to any claim for principal or interest in respect of the debentures.

(2) In the application of the provisions aforesaid, section 530 shall be construed as if the provision for payment of accrued holiday remuneration becoming payable on the termination of employment before or by the effect of the winding up order or resolution were a provision for payment of such remuneration becoming payable on the termination of employment before or by the effect of the appointment of the receiver or possession being taken as aforesaid.

(3) The periods of time mentioned in the said provisions of Part VII shall be reckoned from the date of appointment of the receiver or of possession being taken as aforesaid, as the case may be.

(4) Where the date referred to in sub-section (3) occurred before the commencement of this Act, sub-sections (1) and (3) shall have effect with the substitution, for references to the said provisions of Part VII, of references to the provisions which, by virtue of sub-section (9) of section 530, are deemed to remain in force in the case therein mentioned, and sub-section (2) shall not apply.

(5) Any payments made under this section shall be recouped, as far as may be, out of the assets of the company available for payment of general creditors.

NOTES

Eng. Act, 1948 : Sec. 94 Previous Act : Sec. 129
Eng. Act, 1985 : Sec. 196

Object of section

The object of the section is that debts which are entitled to preferential payments in winding up (see section 530) should also be paid as preferential debts by the receiver who is appointed on behalf of holders of debentures over the property of a company or who takes possession of such property where the property is subject to a floating charge before any payment is made towards the claims of the debenture-holders. It must be noted that the section applies only to cases where the debentures are secured by a floating charge.

Only floating charge holders affected

The priority is only as against payments to the holders of debentures having a floating charge and not in preference to all other payments. In the case of *Re, Glyncorrwg Colliery Co. Ltd.*, (1926) Ch 951 the assets of the company were held applicable in the following order:—

(1) Costs of realisation;

(2) other costs including receiver's remuneration;

(3) costs, charges and expenses of the debenture trust deed including the trustee's remuneration;

(4) plaintiff's costs of action;

(5) preferential creditors;

(6) debenture-holders.

Where the receiver acts in contravention of the section, he will be liable in damages. *Westminster City Council v. Haste,* (1950) 2 All ER 65. See also *Woods v. Winskill,* (1913) 2 Ch 303.

When debentureholder can demand appointment of receiver

The circumstances under which the debenture-holders can apply for appointment of a receiver are: (i) where there is danger of property being lost or diminished in value or (ii) where principal or interest is in arrear or even where there is no such arrear the assets are in danger or (iii) where the company is in liquidation or is on the point of being wound up or (iv) when there are decrees and judgments against the company, *New York Taxicab Co., Re,* (1913) 1 Ch 1; *Lawrence v. West Somerset Rly.,* (1918) 2 Ch 250, or (v) where the company is in a state of suspended animation, or (vi) as in one case where the company wanted to distribute its only asset, which constituted its reserve fund, among its members. *McMohan v. North Kent Iron Works,* (1891) 2 Ch 148; *Thorn v. Nine Reefs Ltd.,* (1892) 67 LT 93; *In Re, Braunstein & Marjolaine,* (1914) WN 335; *Victoria Steamboat Co., Re,* (1897) 1 Ch 158; *Wallace v. Universal Automatic Machines Co.,* (1894) 2 Ch 547; *Colwards v. Standard Rolling Syndicate,* (1893) 1 Ch 574; *Higginson v. German Athenium,* (1916) 32 TLR 277; *Tilt Cove Copper Co., Re,* (1913) 2 Ch 588.

If the money is payable on demand the debenture-holder need only give the company time to implement the mechanics of payment, *e.g.*, to deliver a cheque by return or to transfer the necessary funds from one bank account to another. He is not bound to give the company time to raise the money if it is not at hand or to specify the actual sum due. *Brighty v. Norton,* (1862) 3 B&S 305, 312; *Bank of Baroda v. Panessar,* (1986) 3 All ER 751. *NRG Vision Ltd. v. Churchward Leasing Ltd.,* (1988) BCLC 624. It was no objection to the validity of the appointment that inability to pay debts was not the reason given for the appointment of the receiver at the time it was made but was only adduced subsequently. Accordingly, as the appointment of the receiver was valid, neither the company nor the defendant had any grounds for sustaining an action for damages or repudiation by the plaintiff on the basis that the appointment was invalid. *Byblos Bank SAL v. Al-Khudhairy,* 1987 BCLC 232, 246, 249 (CA). Where the company has neither the money nor any convenient place to go to get it, the interval between the demand and the appointment of the receiver may be as short as one hour. *R. A. Cripps & Son Ltd. v. Wickenden,* (1973) 2 All ER 606. See also *Bunbury Foods Pty. Ltd. v. National Bank of Australasia Ltd.,* (1984) 51 ALR 609 and *ANZ Banking Group (NZ) Ltd. v. Gibson,* (1986) 3 NZCLC 99, 575 (NZCA). Where the receiver is appointed by or on behalf of holders of debentures, secured by both fixed and floating charges, the priority given by this section to preferential creditors applies in respect of the assets charged by way of floating charge. The fixed charge is not affected. *Re, Lewis Merthyr Consolidated Collieries Ltd.,* (1929) 1 Ch 498; *Street v. Mountford,* (1985) AC 809 per LORD TEMPLEMAN.

Administrative receivers were appointed by the court over the assets of a company. The company had transferred its assets to an associated company. The exact arrangement under which the transfer of assets had taken place and what was the financial and commercial relationship between the two companies was very difficult for the court to reconstruct, though there was some evidence that the associated company had acquired its own assets in the course of trading. The debentureholder sought appointment of a receiver and manager for the associated company also. The court granted the order. It was arguable that the associated company was nothing more than the transferor company itself in a new guise. The charge crystallised because of the transfer and the assets transferred remained subject to the charge. The mixed individual assets of the associated company

could be ascertained when an account was taken. *Bank of Credit & Commerce International SA v. BRS Kumar Bros. Ltd.*, (1994) 1 BCLC 211 (Ch D).

The section does not operate so as to affect the position or increase the duties of a receiver appointed on behalf of debenture-holders, before the new Act came into operation. *Re, West Anthracite Collieries Ltd.*, (1949) 2 All ER 736.

§ See also Notes under s. 424.

Effect of appointment of receiver upon directors

The Court of Appeal in *Newhart Developments Ltd. v. Co-operative Commercial Bank Ltd.*, (1978) 2 All ER 896 (CA) laid down that the appointment of a receiver does not deprive the directors to sue on behalf of the company. This decision remained much criticised and accordingly it has now been held by BROWNE-WILKINSON V-C in *Tudor Grange Holdings Ltd. v. Citibank NA*, (1991) BCLC 1009 (Ch D), that the power of directors to sue would normally terminate on receivership unless its exercise would not impinge upon the receiver's functions.

Receiver's report on conduct of directors.—It has been held to be a contempt of court for a person to gain access to and subsequently to publish the contents of an Official Receiver's report on the conduct of directors who were allegedly unfit, where in the circumstances it was known that leave was required for such publication and such leave had not been obtained, *Dobson v. Hastings*, (1992) 2 WLR 414.

§ See also Notes under s. 424.

Effect of receiverships upon unfair prejudice proceedings

The impact of the appointment of an administrative receiver upon unfair prejudice proceedings has been considered by the High Court. Even though unfair prejudice has been established, once such a receiver has been appointed it would no longer be appropriate to order that the petitioner's shares be bought out by the majority shareholders in the company as the change in management of the company had remedied the petitioner's main complaint. Furthermore it would be unfair to ask the respondents to buy the petitioner's shares as they were now almost worthless—*Re, A Company (No. 008126 of 1989)*, (1992) BCC 542.

Receiver an officer of court

When a receiver is appointed by the court, he naturally becomes an officer of the court and any interference with him constitutes a contempt of the court. (*Ames v. Birkenhead Docks Trustees*, (1855) 20 Beav 332; *Russell v. East Anglian Railway Co.*, (1850) 3 Mac & G 104). A receiver who is appointed by a Court is not an agent of anybody and though he is an officer of the Court, he is a principal, *Burt v. Bull*, (1895) 1 QB 276; *Glasdir Copper Mines Ltd., Re*, (1906) 1 Ch 365; *Gardner v. LC Railway Co.*, (1867) 2 Ch App 201.

When a company is being wound up and an application is made on behalf of debenture-holders for the appointment of a receiver, the usual tendency of the court is to appoint the liquidator as the receiver, except, of course, where if there are exceptional circumstances, such as hostility having been shown by the liquidator to the debenture-holders. *Gibs v. Nuthell, Re; House Improvement Supply Assn.*, (1885) WN 51.

Duty of receiver to make preferential payments

The preferential payments are required to be made forthwith out of any assets coming to the hands of the receiver or other person taking possession. *Westminster City Council v. Haste*, (1950) 2 All ER 65 (Ch D). A receiver appointed to enforce a floating charge is not absolved of his obligation to pay preferential claims out of assets coming into his hands simply because liquidation commences at some time during the receivership—*Re, Eisc Teo Ltd.*, (1991) 1 LRM 760. Where the receiver fails to make the preferential pay-

ments, he is liable in tort. If the receiver had been misguided or induced by the debenture-holder, he would be entitled to be indemnified by the debenture-holder. *Westminster City Council v. Treby,* (1936) 2 All ER 21.

Any surplus left after the satisfaction of secured debts by realisation of the charge is payable to the liquidator and not to the preferential creditors. This section applies only to assets subject to the floating charge and not to those subject to a fixed charge. *Re, G.L. Saunders Ltd.,* 1986 BCLC 40 (Ch D).

Sections 421 to 424 should be read in continuation of the Notes of this section.

Position and powers of receivers and managers

The position and powers of a receiver or manager will be governed by the terms contained in the debenture trust deed or instrument, in so far as they are not repugnant to the provisions of any law governing receivers and managers; and in respect of matters not provided for in the deed or instrument, the provisions applying to receivers or managers appointed by the Court, will also apply to them.

In the case of *Latchford v. Beirne,* (1981) 3 All ER 705 (QB) : (1982) 2 Comp LJ 565, the plaintiff guaranteed loans made to a company by a bank which took a debenture covering the assets of the company. The company failed to repay moneys due and the bank in exercise of the powers under debenture appointed a receiver of the company to sell its assets to satisfy the debts owed to the bank. The guarantor issued a writ against the receiver claiming damages for negligence and a breach of duty in selling the company's assets at what was alleged to be less than their proper value. The court held that the receiver owed no duty of care to the guarantor for the following reasons:

(1) Any duty of care owed by the receiver to the company to take reasonable care when realising the assets of the company could not extend to each and every creditor of the company including its guarantors.

(2) The guarantee gave the bank certain rights without giving the guarantor the benefit of any security held by it or the right to complain about the disposal of the security. If the bank itself had exercised the right of sale, the guarantor would have had no redress against the bank. Since the receiver was acting on behalf of the bank and could not be in a weaker position than the bank, it followed that there was no remedy against the receiver.

This judgment was **disapproved** in *Standard Chartered Bank Ltd. v. Walker,* (1982) 3 All ER 938 (CA) where it was held that the receiver is the agent of the company, not of the debenture-holder and, therefore, owes a duty of care not only to the company but also to the guarantor who is liable to the same extent as the company. It is submitted that the judgment in *Latchford v. Beirne, (Supra)* is correct. *Standard Chartered Bank Ltd. v. Walker, (Supra)* was **followed** in *American Express International Banking Corporation v. Hurley,* (1985) 3 All ER 564 : 1986 BCLC 52 (QBD). It was held in that case that a receiver appointed by a mortgagee of the company is in the same position as the mortgagee. When selling the mortgaged property he is bound to take reasonable care to obtain the true market value of the property. It was further held (1) that the mortgagee is not responsible for the acts of the receiver unless the mortgagee interferes with or directs the receiver's activities; (2) the mortgagee is responsible for acts of the receiver when he is acting as the mortgagee's agent.

A receiver, of course, cannot, without special leave, purchase the property of which he is a receiver. *Nugent v. Nugent,* (1908) 1 Ch 546. Though a receiver cannot make or enforce calls in case the company is in liquidation, because the liquidator is the only authority who can do so and where an adequate indemnity is given, the receiver may, if the uncalled capital is included in the mortgage, obtain leave to use the liquidator's name in proceedings to enforce calls. *Fowler v. Broad's Patent Night Light Co.,* (1893) 1 Ch 724; *Harrison v. St. Etienne Brewery Co.,* (1893) 37 Sol J 562.

§ See also Notes under s. 424.

Receiver's costs and remuneration

A receiver's entitlement to receive payments of his costs, expenses and remuneration does not afford him priority over the claims of charges secured on the property which he was appointed by the court to administer. *Choudhri v. Palta,* 1992 BCC 306. This decision was **affirmed** by the Court of Appeal in *Choudhri v. Palta,* (1994) 1 BCLC 184 (CA). Explaining the reason for the rule SCOTT LJ added that where the assets of the partnership are subject to a prior charge, the receiver's entitlement to whatever costs and remuneration he is entitled to, must be deferred to the charge since the assets to the extent of the charge are not the assets of the partnership.

In a most unusual case the court granted an interlocutory injunction to restrain receivers from making further realisations of the mortgaged property to produce funds to pay their remuneration. In this case the receivers had already discharged the sums owing to the debentureholder. Before actually selling the property for their remuneration, they had to wait for the settlement of dispute about the fact that might show that they already had sufficient funds in their hands for their remuneration. The *quantum* of the remuneration had to be determined before allowing further realisations (which might prove unnecessary) to go ahead—*Rottenberg v. Monjack,* 1993 BCLC 374 (Ch D).

§ See also Notes under s. 424.

Receiver's lien

In a dispute over the ownership of a company the court appointed a receiver and manager. After the resolution of that dispute a question arose as to how the costs of the receiver were to be met. It was held that the receiver's costs, remuneration and indemnity were to be satisfied out of all of the assets subject to the receivership and not just those assets which he had taken possession of. The fact that the receivership order had been discharged and assets surrendered by the receiver did not affect his lien for cost which existed independently of possession—*Mellor v. Mellor,* (1992) 4 All ER 10 : 1993 BCLC 30.