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Prospectus

Statement in lieu of prospectus [S. 70]

One of the great advantages of promoting a company is that the necessary capital for business can be raised from the general public by means of a public issue. This advantage is, however, enjoyed only by a public company which is listed at a recognised stock exchange. "A listed public company means a public company which has any of its securities listed in any recognised stock exchange."[1] A private company is, by its very constitution, prohibited from inviting monetary participation of the public.[2] But even a public company need not necessarily go to the public for money. The promoters may be confident of obtaining the required capital through private contacts. In such a case no prospectus need be issued to the public. The company can remain as an unlisted public company,[3] or even if listed, it can think in terms of managing its financial requirements through private access rather than public issue. In such cases the company is only required to prepare a draft prospectus containing the information required to be disclosed by Schedule III of the Act. This document is known as a "Statement in Lieu of Prospectus". A copy of it must be filed with the Registrar at least three days before any allotment of shares is made.[4] This is intended to preserve an authoritative record of the terms and conditions of the capital issue. If the statement contains any misrepresentation or omission, the liability, civil and criminal, is the same as in the case of an issued prospectus.[5]

The process of issuing securities through a statement in lieu of prospectus is a kind of private placement. The other documents, namely, a copy of the statement in lieu of prospectus and application form, are not issued to the public in general. They are circulated among selected persons for their personal use and with no right to pass them on to others. This method is gradually slipping into the hands of banking and financial institutions. The functioning is in the name of book building process. Orders are collected from investment bankers and larger investors based on an indicative price. SEBI guidelines have been issued.[6] Even in the case of a public issue, operation through book building is allowed to the extent to which reservation in issues is permissible. It will be identified separately in the placement portion. Where the issue is above one crore rupees, book building process can be used to the extent of 100%. The

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1 As stated in S. 2(23-A), *inserted* by the Amendment of 2000.

2 S. 3(3)(c).

3 Its shares can be traded as unlisted securities at Over the Counter Exchanges.

4 There is a penalty for contravention which may extend up to ten thousand rupees. The liability is that of the company and guilty officers. S. 70(4).

5 Criminal liability for misrepresentation in prospectus is imprisonment up to two years or fine extending up to fifty thousand rupees or both. *See* S. 70(5) and *Blair Open Hearth Furnace Co Ltd, Re*, [1914] 1 Ch 390; (1914) 109 LT 839.

6 Clarification XIII, Dec 12, 1995; Clarification XVII, 9-12-1996 and Clarification XXI, 23-10-1997.

process is advantageous because the demand for and value the company's securities is discovered by providing price flexibility.

Most companies have, however, to issue a public appeal for subscription. This involves the issue of a prospectus. No applications for shares or debentures of a company can be invited unless the appeal is accompanied by a memorandum containing such salient features of a prospectus as may be prescribed, and complying with the requirements of the section.[7]

Definition of prospectus [S. 2(36)]

Prospectus is defined by Section 2(36). "A prospectus means any document described or issued as prospectus and includes any notice, circular, advertisement or other document inviting deposits from the public or inviting offers from the public for the subscription or purchase of any shares in or debentures of a body corporate." In essence, it means that a prospectus is an invitation issued to the public to take shares or debentures of the company or to deposit money with the company.

Application forms not to be issued unless accompanied by prospectus or abridged prospectus

Any advertisement offering to the public shares or debentures of the company for sale is a prospectus. Application forms for shares or debentures cannot be issued unless they are accompanied by a prospectus. Publication cost of a prospectus had become very expensive and, therefore, the 1988 amendment introduced the concept of an abridged prospectus.[8] It is a memorandum containing such salient features of a prospectus as may be prescribed.[9] Thus the effect is that only a document has to be sent along with application forms showing a brief version of the salient features of the prospectus. One abridged prospectus can carry two application forms.

In a Calcutta case[10] an advertisement was inserted in a newspaper stating: "Some shares are still available for sale according to the terms of the prospectus of the company which can be obtained on application." This was held to be a prospectus as it invited the public to purchase shares. The directors were accordingly convicted under Section 92(5) [now Section 60(5)] for not complying with the disclosure requirements of the Act.

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7 S. 56(3).

8 Now defined in S. 2(1), *vide* amendment of 2000.

9 Substituted for the requirement of full prospectus by the amendment of S. 56(3) in 1988. A proviso added to clause (*b*) prescribes that a full prospectus would have to be made available to a person who makes a request for it before the closing of the subscription list. Two application forms can be issued with one abridged prospectus. Abridged prospectus has to be drawn in accordance with Form 2-A of Annexure A to the Companies (Central Government's) General Rules and Forms, 1956. There should be nothing in it which is not there in the full prospectus.

10 *Pramatha Nath Sanyal* v *Kali Kumar Dutt*, AIR 1925 Cal 714: 88 IC 5: 29 CWN 523.

Information Memorandum

Consequent upon introduction of a new variety of prospectus, namely, shelf or red-herring prospectus, the concept of "information memorandum" has been defined in Section 2(19-B) by the Amendment Act of 2000. It is as follows:

"Information memorandum means a process undertaken prior to the filing of a prospectus by which a demand for the securities proposed to be issued by a company is elicited, and the price and the terms of issue for such securities are assessed by means of a notice, circular, advertisement or document."

Public issue

The provisions of the Act relating to prospectus are not attracted unless the prospectus is issued. "Issued" here means issued to the public.[11] What does or does not amount to an issue is a question of fact in each case and is not capable of exact definition. In *Nash* v *Lynd*[12] it was held that "the term 'issue' is not satisfied by a single private communication".

> The facts were that a document marked "strictly private and confidential" but in form a prospectus was prepared by the defendant, the managing director of a company. But the document did not contain all the material facts required by the Act to be disclosed. A copy of it along with application forms was sent to a solicitor who in turn sent it to the plaintiff.

It was held that this did not amount to an issue and accordingly the plaintiff's action for compensation for loss sustained by reason of the omissions was dismissed. Viscount SUMNER said:

> "It is difficult to think of a prospectus being issued without some measure of publicity, however modest.... Though literally it is true that the issue is not expressly said in the section[13] to be an issue to the public, I think it must be so in substance, otherwise any private letter, written by a person engaged in forming a company and advising his correspondent to take shares... would become an issued prospectus. 'The public' is of course a general word. No particular numbers are prescribed. Anything from two to infinity may serve: perhaps even one, if he is intended to be the first of a series of subscribers, but makes further proceedings needless by himself subscribing the whole. The point is that the offer is such as to be open to anyone who brings his money and applies in due form, whether the prospectus was addressed to him on behalf of the company or not. A private communication is not thus open."

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11 The Act says in S. 2(22) that "issued generally" means, in relation to a prospectus, issued to persons irrespective of their being existing members or debenture-holders of the body corporate to which the prospectus relates. Section 67 says that no offer or invitation shall be treated as made to the public if it is not calculated to become available to persons other than addressees or is otherwise a domestic concern of the persons making and receiving the offer etc. The Amendment of 2000 has restricted this number to 50 persons. The effect is that any circulation to more than 50 persons would become a public offer.

12 1929 AC 158: 140 LT 146. *See* also *Sherwell* v *Combined Incandescent Mantles Syndicate Ltd*, (1907) 23 TLR 482; *Baty* v *Keswick*, (1901) 85 LT 18: 17 TLR 664.

13 S. 81(*i*) of the [English] Companies Consolidation Act, 1908; Section 56 of the present Indian Companies Act, 1956.

Thus the issue need not be made to the public as a whole. An advertisement among a group or a class of persons only would be an issue also. Accordingly, where 3000 copies of a document in the form of a prospectus were sent out and distributed among the members of certain gas companies only, it was held to be an offer of shares to the public.[14] Section 67(1) of the Act also provides that in the context of offering shares or debentures to the public or invitation to the public to subscribe for shares or debentures, the term 'public' includes any section of the public, whether selected as members or debenture-holders of the company concerned or as clients of the person issuing the prospectus or in any other manner.

In the following cases, however, although shares are offered and application forms issued, a prospectus containing all the details is not necessary:

1. Where the offer is made in connection with a *bona fide* invitation to a person to enter into an underwriting agreement with respect to the shares or debentures.

2. Where the shares or debentures are not offered to the public.[15]

3. Where the offer is made only to the existing members or debenture holders of the company.

4. Where the shares or debentures offered are in all respects uniform with shares or debentures already issued and quoted on a recognised stock exchange.[16]

5. Where a prospectus is issued as a newspaper advertisement, it is not necessary to specify the contents of the memorandum, or the names etc., of the signatories to the memorandum or the number of shares subscribed for by them.[17]

Contents of prospectus and formalities of issue

"The investor wants a sound concern."[18] Prospectus is one of the means by which he is informed of the soundness of the company's venture.[19] That indeed is the basic function of the prospectus. But this fact also affords an opportunity to directors and promoters to impose a fraud on the public. "The Companies Act accordingly now contains a comprehensive set of regulations intended to protect the investing public from such victimization."[20] The chief aim of the Legislature in making these regulations, is "to secure the fullest disclosure of all material and essential particulars and lay the same in full view of the intending

14 *South of England Natural Gas and Petroleum Co, Re,* [1911] 1 Ch 573: 104 LT 378: 80 LJ Ch 358.

15 S. 56(3)(*a*) and (*b*). *See* Frank Evans, *Abridged Prospectus,* 27 LQR 286 (1911). Circulation of private and confidential letters for placement of shares to the addressees with right to renounce in favour of others would have the effect of making the offer to the public and would go beyond the scope of this exception. *See* Press Note of 6-7-1992, No 7/921.

16 S. 56(5)(*a*) and (*b*).

17 S. 66.

18 An observation in *Baty* v *Kiswick,* (1901) 85 LT 18: 17 TLR 664.

19 KINDERSLEY VC in *New Brunswick etc Co* v *Muggeridge,* (1860) 3 LT 651: 30 LJ Ch 242.

20 J. A. Hornby, AN INTRODUCTION TO COMPANY LAW, 54 (1st Edn, 1957).

purchasers of shares."[21] The relevant rules and regulations are briefly set out below:

1. *Every prospectus to be dated* [S. 55]

Every prospectus has to be dated. This ensures a *prima facie* evidence of the date of its publication.[22]

2. *Every prospectus to be registered* [S. 60]

A copy of every prospectus has to be registered with the Registrar of Companies. This preserves an authoritative record of the terms and conditions of the capital issue. Registration must be made on or before the publication of the prospectus. The copy sent for registration must be signed by every person who is named in the prospectus as a director or a proposed director of the company. The copy for registration must be accompanied with—

(*a*) if a report of an expert is to be published, consent of the expert;[23]

(*b*) a copy of every contract relating to appointment and remuneration of managerial personnel;[24]

(*c*) a copy of every material contract, unless it is entered into in the ordinary course of business or two years before the date of the prospectus;[25]

(*d*) a written statement relating to the adjustments, if any, "as respects the figures of any profits or losses or assets and liabilities", dealt with in any report set out in the prospectus in pursuance to Part II of Schedule II. The statement should give reasons for the adjustments and be signed by an expert;[26]

(*e*) the consent in writing of the person, if any, named in the prospectus as the auditor, legal advisor, attorney, solicitor, banker or broker of the company, to act in that capacity.[27]

The prospectus must be issued within ninety days of its registration.[28] The company and every person who knowingly issues a prospectus without registration is punishable with a fine which may extend up to fifty thousand rupees.[29] It must be stated on the face of the prospectus that it has been registered and that the requisite documents, giving names, have been filed.[30]

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21 *Pramatha Nath Sanyal* v *Kali Kumar Dutt*, AIR 1925 Cal 714: 88 IC 5: 29 CWN 523.

22 The date of issue is important to very many things connected with the prospectus, for example, pricing of the issue is related to the value of the proffered securities to the timing of the issue. The date mentioned on the prospectus, unless the contrary is proved, is taken as the date of publication of prospectus. [S. 55]

23 S. 60(1)(*a*).

24 S. 60(1)(*b*) and clause 16 of Schedule II.

25 *Ibid* and clause 16(1)(*b*) of Schedule II.

26 S. 60(1)(*b*)(*ii*) and clause 32 of Schedule II.

27 S. 60(3).

28 S. 60(4).

29 S. 60(5). See *Pramatha Nath Sanyal* v *Kali Kumar Dutt*, AIR 1925 Cal 714: 88 IC 5: 29 CWN 523; *Mansukhlal* v *Jupiter Airways Ltd*, (1951) 54 Bom LR 777 and *Superintendent and Remembrance of Legal Affairs, Bengal* v *The Bengal Salt Co*, (1936) 40 CWN 320, where a variation between the registered prospectus and its Bangla translation which was issued rendered the promoters liable to conviction.

30 S. 60(2)(*a*) and (*b*).

The Registrar is under duty not to register a prospectus which does not comply with the requirements of Sections 55, 56, 57 and 58 and 60(1) and (2) and which does not contain the consent in writing of the person, if any, named in the prospectus as auditor, legal adviser, attorney, solicitor, banker or broker of the company. The consent should be his acceptance to act in that capacity.[31] Section 61 provides that the contracts which are referred to in the prospectus or in a statement in lieu of it, are not to be varied unless the variation is approved by the company in general meeting or made under its authority.[32]

3. *Expert's consent* [S. 58]

If the prospectus includes a statement purporting to be made by an expert, consent in writing of that expert must be obtained and this fact should be stated in the prospectus. The expert should not be one who is himself engaged or interested in the formation, promotion or management of the company.[33] He should be unconnected with the formation or management of the company. "This section enacts a wholesome rule intended to protect an intending investor by making the expert a party to the issue of the prospectus and making him liable for untrue statements."[34]

4. *Disclosures to be made* [S. 56]

Section 56 requires every prospectus to disclose the matters specified in Schedule II of the Act.[35] The Schedule is divided into three parts. Part I contains the matters to be specified, Part II, the reports to be set out, while Part III is explanatory of Parts I and II.

PART I

This part has to disclose some general information, capital structure of the company, terms of the present issue, particulars of the issue, company,

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31 S. 60(3).

32 Where the letters of offer for allotment of shares stated that the money collected from the issue was to be used for the specified purposes, it was held that the shareholders could by a resolution permit the use of money for different purposes. *Kothari Industrial Corpn Ltd* v *Maxwell Dyes and Chemicals (P) Ltd*, (1996) 85 Comp Cas 79: (1995) 18 Corpt LA 22 (Mad). This decision of the single judge was affirmed by the Division Bench in *Maxwell Dyes and Chemicals (P) Ltd* v *Kothari Industrial Corpn Ltd*, (1996) 85 Comp Cases 111: (1996) 20 Corpt LA 247 (Mad) (DB). The change over in the deployment of issue proceeds was permitted by all financial and lead institutions and Governmental authorities. Matters relating to violation of this section are not within the jurisdiction of a civil court. They are the subject-matter of a civil suit before any competent civil court, *Poonam Chand Kothari* v *Rajasthan Tubes Mfg Co Ltd*, (1996) 87 Comp Cas 842 Raj. Shifting registered office even before allotment to some place other than that mentioned in the prospectus does not come within the scope of S. 61, *Pal Peugeot Ltd Re*, (1997) 89 Comp Cas 808 CLB.

33 S. 57. *See also* S. 59 which defines "expert". S. 59(2) says that "the expression "expert" includes an engineer, a valuer, an accountant and any other person whose profession gives authority to a statement made by him".

34 Report of the Company Law Committee, (1952) 46. The administration of power under the section and S. 57 has been vested in SEBI w.e.f. 13-12-2000.

35 S. 56(1). Schedule II was recast in 1991. Non-disclosure is a punishable offence. The power of taking action has been delegated to SEBI [GSR Notification of Nov 24, 1993]. Similar delegation has been made under S. 59.

management and project, particulars in regard to the company and other listed companies under the same management which made any capital issue during the last three years, information about certain pending litigation, management perception of risk factors e.g., sensitivity to foreign exchange rate fluctuations, difficulty in availability of raw materials, or in marketing of products, cost-time overrun, etc.

PART II

This part has to carry some general information[36] and financial information in terms of reports relating to profits and losses and assets and liabilities of the company. Report must refer to the rates of dividends, if any, paid by the company in respect of each class of shares for each of the five financial years before the issue of the prospectus. The report of the auditors must also state separately the profits and losses of the company's subsidiaries and also combined profits and losses. If the company proposes to acquire any business, a report should be made by an accountant, whose name should be disclosed, upon the profits and losses of the business for five years before the date of the prospectus and assets and liabilities of the business.[37] This part has also to carry disclosures as to utilisation of proceeds of the issue and some statutory and other information.

Part III offers some explanations about the contents of Parts I and II.

Shelf Prospectus [S. 60-A]

Filing of a shelf prospectus has been made compulsory for any public financial institution, public sector bank, or a scheduled bank whose main object is financing. The advantage to the filing company is that it shall not have to file a prospectus every time it issues securities within the period of validity of such prospectus. The meaning of a shelf prospectus (like information contained in a file lying on a shelf) is confined to a prospectus

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36 Relating to consent of the concerned parties; changes, if any, in directorship during the last three years; resolutions authorising issue, procedure and time schedule for allotment and names and addresses of the secretary, legal adviser, lead managers, co-managers, auditors, bankers and brokers. *Kothari Orient Finance Ltd* v *Tele Data Informatics Ltd*, (2002) 108 Comp Cas 863 (Mad) a prospectus was not restrained on the allegation of the financier that the debt owed to him was not disclosed. The company disclosed the same in a subsequent newspaper advertisement and SEBI which had okayed the issue, did not withdraw its permission even after the complaint.

37 These are the only disclosure requirements which have to be published in the prospectus. Formerly, a licence for public issue had to be obtained from the Controller of Capital Issues. That office was abolished and substituted by Securities and Exchange Board of India (SEBI). It issued guidelines in 1992 as to disclosure requirements for investor protection. SEBI renders the service of vetting the prospectus. For this purpose they need a lot of information for the consumption of their own office by looking at which they can find out whether the prescribed regulations have been followed or not, for example, whether the promoters have taken their requisite quota, pricing norms have been followed, prescribed gaps between two issues have been observed and the like. Preparation of a prospectus through a lead merchant (merchant bankers) and their certificate to the effect that SEBI disclosure requirements have been satisfied amounts to automatic SEBI vetting. Thus prospectus issue has become virtually free. Vetting is also not required where the issuer company has a three-year track record of dividend payment. The administration of powers under the section has been vested in SEBI.

issued by financial institutions or banks. A company filing such prospectus is also required to file an information memorandum on all material facts relating to new charges created, changes occurring in the financial position in the period from first offer of securities, previous offer of securities and the succeeding offer within such time as may be prescribed by the Central Government prior to the making of a second or subsequent offer of securities under the shelf prospectus. The information memorandum has to be issued to the public along with the shelf prospectus at the stage of first offer of securities. The prospectus remains valid for one year from the date of opening of the first issue of securities. Where an update of the information is filed every time an offer of securities is made, such memorandum together with the shelf prospectus shall constitute the prospectus. Financing means making loans to or subscribing to the capital of a private industrial enterprise engaged in infrastructure financing or such other company as the Central Government may notify for this purpose.

Information memorandum [S. 60-B]

A public company making an issue of securities may circulate an information memorandum to the public prior to the filing of a prospectus. A company which invites subscription by means of an information memorandum has to file a prospectus prior to the opening of the subscription list and the offer as a red-herring prospectus, at least three days before the opening of the offer. The information memorandum and the red-herring prospectus carry the same obligations as are applicable to a conventional prospectus. The issuing company has to highlight any variations between the information memorandum and the red-herring prospectus. For the purposes of the provisions contained in first four sub-sections of Section 60-B a red-herring prospectus means a prospectus which does not offer complete information on the price and the quantum of the securities proposed to be issued.[38]

Variations must be individually intimated to the persons invited. Where payment has been received in advance by means of drafts, cheques, etc, they shall not be encashed without first individually intimating to the prospective subscribers the fact of the variations and without giving them an opportunity to withdraw their applications. Applications may be withdrawn within seven days of the intimation of the variation. If any allotment is made without complying with this requirement it is void. The applicants shall be entitled to be paid back their subscription money with 15% interest.

On completion of allotment and closing of the offer of securities, a final prospectus has to be prepared completing the information which was missing in the red-herring prospectus, namely, the amount of capital raised whether by way of debt or share capital, the closing price of the securities, etc. Such prospectus has to be filed with SEBI in the case of a listed public company and with the Registrar in other cases.

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38 S. 60-B(4) *Explanation*.

Issuing houses and deemed prospectus (S. 64)

These requirements show that "provisions relating to prospectus are most stringent and the duty of preparing and filing it in accordance with the law is extremely onerous".[39] But these onerous requirements were often evaded by companies in this way. The whole of the capital of a company was allotted to an intermediary known as an "Issuing House". The "House" then offered the shares to the public by means of an advertisement of its own, which was obviously not a prospectus and thus the requirements of the Act relating to prospectus were evaded. But now every such advertisement sponsored by an "Issuing House" is known as an "offer for sale" and is deemed to be a prospectus issued by the company. The responsibility of the company, its directors and promoters is, therefore, the same. In addition, the "Issuing House" incurs its own liability.[40]

Now, how is it to be known whether an agreement to allot shares to an "Issuing House" is intended for the shares to be offered to the public. Apart from the express provisions of the agreement, the Act provides in Section 64(2) that the intention to offer shares to the public shall be presumed in the following cases:

1. where the "Issuing House" offers the shares to the public for sale within six months after they were allotted or agreed to be allotted to the House; or
2. where at the date of offer to the public, the whole of the consideration to be received by the company in respect of shares has not been received.

The prospectus issued by an "Issuing House" shall state the following further particulars:[41]

1. net amount of consideration to be received by the company in respect of those shares, and
2. place and time at which relevant contracts may be inspected.

Disclosures should give true and fair view of company's position

Above all, the golden rule as to the framing of prospectus must be observed. The rule was laid down by KINDERSELY VC in *New Brunswick and Canada Rly and Land Co* v *Muggeridge*[42] and was described as a "golden legacy" by PAGE WOOD VC in *Henderson* v *Lacon*.[43] Briefly, the rule is this:

> Those who issue a prospectus hold out to the public great advantages which will accrue to the persons who will take shares in the proposed undertaking. Public is invited to take shares on the faith of the representations

39 Quoted from the judgment in *Pramatha Nath Sanyal* v *Kali Kumar Dutt*, AIR 1925 Cal 714: 88 IC 5: 29 CWN 523.
40 S. 54(1).
41 S. 69(3).
42 (1860) 3 LT 651: 30 LJ Ch 242.
43 (1867) 17 LT 527: 59 LJ Ch 794: 5 Eq 249.

contained in the prospectus. The public is at the mercy of company promoters. Everything must, therefore, be stated with strict and scrupulous accuracy. Nothing should be stated as fact which is not so, and no fact should be omitted the existence of which might in any degree affect the nature or quality of the privileges and advantages which the prospectus holds out as inducement to take shares. In a word, the true nature of the company's venture should be disclosed.

This golden legacy has condensed in few words the whole doctrine as to the rule of conduct between shareholders and directors.[44]

REMEDIES FOR MISREPRESENTATION

These stringent provisions have proved to be very useful. As a result litigation on this subject has already declined. The fear of heavy liability and of criminal sanctions has controlled the directors' tendency of "using extravagant terms and flattering descriptions".[45] The law allows the following remedies for misrepresentation in a prospectus.

1. Damages for deceit

Deceit is a tort. It means fraud. Anyone who has been induced to invest money in a company by a fraudulent statement in a prospectus can sue the persons responsible for issuing it. If his action is successful he recovers full compensation for the loss sustained by him directly as a result of the fraud. But the burden of proof lies on him to establish the following main points of the action. When a claim under the tort of deceit has been established, the amount of damages would not be reduced on the ground of contributory negligence, if any, on the part of the claimant.[46]

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44 (1867) 17 LT 527: 59 LJ Ch 794: 5 Eq 249. In addition to these requirements of the Companies Act, SEBI's guidelines for disclosures in prospectus have also to be observed. *See* SEBI Guidelines for Disclosure and Investor Protection of 1992. Securities and Exchange Board of India, with headquarters at Bombay, was established under the SEBI Act, 1992 to take over the supervision of the capital market from the erstwhile Controller of Capital Issues who was functioning under the now repealed Capital Issues Control Act, 1947. SEBI is functioning by subdividing its workload into two divisions, one for controlling the primary market, namely issue of securities and the other for controlling the market transactions in securities, the secondary market. For issue of securities it has laid down guidelines as to disclosures in accordance with which prospectus must be prepared for vetting. For transactions in securities markets it has identified a number of market intermediaries who have been subjected to discipline through registration and conduct rules. Section 55-A provides that provisions of Sections 55 to 58, 59 to 84, 108, 109, 110, 112, 113, 116, 117, 118, 119, 120, 121, 122, 206, 206-A, in so far as they relate to issue and transfer of securities and non-payment of dividend are to be administered by SEBI in case of listed public companies and companies intend to get their securities listed on any recognised stock exchange. In other respects, the administration has to be by the Central Government. The *Explanation* to the section says that all powers relating to all other matters including prospectus, statement in lieu of prospectus, return of allotment, issue of shares and redemption of irredeemable preference shares are to be exercised by the Central Government, Tribunal or the Registrars of Companies.

45 Lord CAIRNS in *Peek* v *Gurney*, (1873) 43 LJ Ch 19 at 40: [1861-73] All ER Rep 116: LR 6 HL 377.

46 *Standard Chartered Bank* v *Pakistan National Shipping Corpn (No 2)*, [2000] 1 Lloyds Rep 218 CA.

Fraudulent misstatement

In the first place, the plaintiff must prove that there was a fraudulent misstatement. "To support an action of deceit", said Lord HERSCHELL[47], "fraud must be proved and nothing less than fraud will do. Fraud is proved when it is shown that false representation has been made—

(*a*) knowingly, or

(*b*) without belief in its truth, or

(*c*) recklessly, carelessly whether it be false or true."

In other words, if the directors publish a statement with knowledge that it is false or without any knowledge, whether it is true or false, it is a fraud. "Fraud may be committed by reckless representations without knowing how the matter stands one way or the other".[48] Section 17 of the Indian Contract Act defines "fraud" as including, among other things, the suggestion that a fact is true when it is not so and the person making the suggestion does not believe it to be true and the active concealment of a fact. These definitions show that if the person making the statement honestly believes it to be true, he is not guilty of fraud, even if the statement is not true. *Derry* v *Peek*[49] involved a situation of this kind.

> A special Act incorporating a tramway company provided that carriages might be moved by animal power and, with the consent of the Board of Trade, by steam power. The directors issued a prospectus containing a statement that by their special Act, the company had the right to use steam power instead of horses and that a saving would be effected thereby. No reference was made to the Board of Trade who refused their consent. Consequently, the company had to be wound up. The plaintiff having taken shares on the faith of the statement brought an action of deceit against the directors. But they were held not liable.

The statement was certainly untrue because the power to use steam was stated to be an absolute right, when in truth it was conditional on the approval of the Board of Trade. But the directors honestly believed that once the Act of Parliament had authorised the use of steam the consent of the Board of Trade was practically concluded.

Representation relating to fact

Secondly, the false representation must relate to some existing facts which are material to the contract of purchasing shares. The purposes for which the new money is going to be used is an important fact. In *Edgington* v *Fitzmaurice*,[50] for example—

> The directors of a company issued a prospectus inviting subscriptions for debentures and stating that the objects of the issue of debentures were to

47 *Derry* v *Peek*, (1889) 14 AC 337: (1886-90) All ER Rep 1: (1889) 5 LQR 410.

48 DENMAN LJ in *Edgington* v *Fitzmaurice*, (1885) 29 Ch D 459, 465: (1885) 53 LT 369.

49 (1889) 14 AC 337: (1886-90) All ER Rep 1.

50 (1885) 29 Ch D 459: (1885) 53 LT 369.

complete alterations in the buildings of the company, to purchase horses and vans and to develop the trade of the company. The real object of the loan, however, was to enable the directors to pay off pressing liabilities. Relying upon the statement the plaintiff advanced money. The company became insolvent and the plaintiff sued the directors for fraud.

The directors argued that the suggestion of possible purposes to which the money might be applied was not a statement of existing facts. But they were held liable. BOWEN LJ said that the directors had misrepresented their state of mind and "the state of a man's mind is as much a fact as the state of his digestion". The statement was also regarded as material to the contract. "A man who lends money reasonably wishes to know for what purpose it is borrowed, and he is more willing to advance it if he knows that it is not wanted to pay off liabilities already incurred."[51]

Remedy of Direct Allottees

Thirdly, the plaintiff should have taken the shares directly from the company by allotment. "Those only who are drawn in by the misrepresentation in the prospectus to become allottees can have a remedy against the directors."[52] A purchaser of shares in the open market has no remedy against the company or the promoters though he might have bought on the faith of the representations contained in the prospectus. This rule owes its origin to *Peek* v *Gurney*.[53]

A deceitful prospectus was issued by the defendants on behalf of a company. The plaintiff received a copy of it but did not take any shares originally in the company. The allotment was completed and several months afterwards the plaintiff bought 2000 shares on the stock exchange. His action against the directors for deceit was rejected. "The office of a prospectus", the Court said, "is to invite persons to become allottees, and, the allotment having been completed, such office is exhausted and the liability to allottees does not follow the shares into the hands of subsequent transferees. Directors cannot be made liable ad infinitum for all the subsequent dealings which may take place with regard to those shares upon the stock exchange."[54]

Buyers in Secondary Market

But "where the object with which the prospectus of a company is issued is not merely to induce applications for allotment of shares, but also to induce persons to whom it is sent to purchase shares in the market, its function is not exhausted when the company has gone to allotment, and the person issuing the prospectus is responsible for the consequences of false representation contained in it".[55] In other words, "there must be something to connect the directors

51 Another illustration of liability for fraud, *S Chatterjee* v *T.B. Sarwate*, AIR 1960 MP 322.

52 *Peek* v *Gurney*, (1873) 43 LJ Ch 19: [1861-73] All ER Rep 116: LR 6 HL 377.

53 (1873) 43 LJ Ch 19: [1861-73] All ER Rep 116: LR 6 HL 377.

54 Similar is the position of a person in whose favour shares were renounced. For a criticism of this principle, see *Joseph H. Gross*, (1973) 36 Mod LR 600. *See* also *Collins* v *Associated Greyhound Racecourses Ltd*, [1930] 1 Ch 1: (1930) 141 LT 529.

55 RIGBY LJ in *Andrews* v *Mockford*, (1896) 1 QB 372, 383: (1896) 73 LT 726.

making the representation with the party complaining that he has been deceived and injured by it, as, for example, where the fraudulent prospectus is delivered to a person who thereupon becomes a purchaser of shares".[56] This principle found application in *Andrews* v *Mockford*.[57]

> The defendants sent to the plaintiff a prospectus of a company which they knew would be a sham or pretended company in order to induce the plaintiff to purchase shares therein. The plaintiff did not then do so. The prospectus, having produced but a scanty subscription for shares, the defendants thereupon fraudulently published a telegram in a newspaper. The plaintiff believing in the truth of the telegram was induced to purchase shares in the open market. The directors were held liable for the systematic fraud. "The function of the prospectus was not exhausted, and the false telegram was brought into play by the defendants to reflect back upon and countenance the false statements in the prospectus."

Further, by reason of the decision of the House of Lords in *Hedley Byrne & Co* v *Heller & Partners*,[58] a person may become liable for holding out a false statement to anyone whom he knew or ought to have known would act in reliance upon the statement.

Where a prospectus was circulated among the existing shareholders inviting them to subscribe to the company's rights issue and one of them, thinking that the offer was good, not only accepted the rights shares offered to him, but also bought more shares of the category in the market. He was not allowed to hold the directors liable for misleading statements in the prospectus in respect of his market purchases. The court said that there was no sufficient proximity for a duty to be owed to those buying shares in the open market.[59]

Further developments in this respect have been noted in *Possfund Custodian Trustee Ltd* v *Diamond*.[60] The prospectus here was for floatation of securities on the unlisted securities market. A majority of the complainants were original allottees and others were buyers in the open market. (after-market purchasers) The company went into receivership. There were actions against the company for false statements in the prospectus. The company applied for striking out the claims of after market purchasers. The court said that such purchasers would have to establish that they had reasonably relied on the representations made in the prospectus and reasonably believed that the representor intended them to act on the statements and that there existed a sufficiently direct connection between the purchaser and the representor to render the imposition of such a duty fair, just and reasonable. The wide publicity of a prospectus would go to show that the intention was to influence not only the first buyers but also subsequent

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56 *Peek* v *Gurney*, (1873) 43 LJ Ch 19 at 38: [1861-73] All ER Rep 116: LR 6 HL 377. The *Explanation* to S. 19, Indian Contract Act.

57 (1896) 1 QB 372: (1896) 73 LT 726.

58 [1963] 3 WLR 101: 1964 AC 465: [1963] 2 All ER 575.

59 *Al-Nabib Investments (Jersey)* v *Longcroft*, (1991) BCLC 7 Ch D applying *Capro Industries plc* v *Dickman*, [1990] 1 All ER 568: [1990] 2 WLR 358 HL: (1990) BCLC 273 HL.

60 (1996) 2 BCLC 665 Ch D and also *Parr* v *Diamond*, (1996) 2 BCLC 665 Ch D.

market operations. The issue should, therefore, be tried on merits and was not to be struck out.

Liability of Company

The company may also be sued for damages provided that the fraud was committed by the directors within the scope of their authority. But the action against the company is beset with the limitation laid down by the House of Lords in *Houldsworth* v *City of Glasgow Bank*,[61] that the contract of allotment must first be rescinded. One cannot remain in the company as a shareholder and yet sue it for damages.[62] But the English Misrepresentation Act, 1967 now "entitles the Court to award damages in lieu of rescission".[63] Thus, rescission is no longer necessary as a prerequisite for liability of the company.

2. Compensation under Section 62

The decision of the House of Lords in *Derry* v *Peek*[64] exposed the inadequacy of the tort action of deceit to protect the interest of investors in public companies. The directors in that case had, no doubt, told their falsehood in good faith rather than from corrupt motive.[65] But that would not console the misled investor for he is not concerned with the state of the directors' mind or conscience. His loss is just the same whether the misrepresentation is innocent or fraudulent. Accordingly, within a year of the decision in *Derry* v *Peek* the Directors' Liability Act[66] was passed and the directors were made answerable for false statements although they might have believed their assertions to be substantially true. The provisions of this Act have been re-enacted in Section 43 of the English Companies Act, 1948. Section 62 is the corresponding provision in the Indian Act. Following persons are liable under this section:[67]

1. Every person who is a director of the company at the time of the issue of the prospectus.
2. Every person who has authorised himself to be named as a director in the prospectus.
3. Every promoter who was a party to the preparation of the prospectus.[68]
4. Every person who authorised the issue of the prospectus.

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61 (1880) 5 App Cas 317: (1880) 42 LT 194 HL.

62 Followed in *Addlestone Linoleum Co, Re*, (1887) 37 Ch D 191 CA.

63 S. 2(2). *See* GOWER, PRINCIPLES OF MODERN COMPANY LAW, 316 (3rd Edn, 1969).

64 (1889) 14 AC 337: [1886-90] All ER Rep 1: (1889) 5 LQR 410.

65 *See* Fredrich Pollock, *Derry* v *Peek in the House of Lords*, (1889) 5 LQR 410, Edward Manson, *The Reform of Company Law*, (1889) 5 LQR 61, 67. The amount of compensation to the misled investor is the value taken from him and the real value of the share. One method of ascertaining such value is to see the difference between the allotment value and the market value of the security, *Smith New Court Securities Ltd* v *Scrimgeour Trust Ltd*, (1997) 1 BCLC 350 HL. Here the price which the buyer paid for the share less the price which he realised on resale was allowed by way of compensation. Delay on his part in reselling the share was not taken into account because he has justifiable reasons for the delay.

66 53 & 54 Vict c 64 of 1890.

67 S. 62(1).

68 S. 62(*a*) and (*b*).

They are liable to compensate the investor for any loss sustained by him by reason of any untrue statement contained in the prospectus.[69] A statement is deemed to be untrue if it is false in the form and context in which it is included.[70] Omissions which are calculated to mislead shall also render the prospectus false.[71] An instance of liability under the section is provided by *Greenwood* v *Leather Shod Wheel Co.*[72]

> The prospectus issued by a wheel manufacturing company stated: "Orders have already been received (inter alia), from the House of Commons.... Wheels for the trolleys in the House of Commons have been ordered and are now in use." In fact no single order had been obtained except for trial and by way of experiment. It was held that the prospectus contained untrue statement.

The chief advantage of proceeding under this section is that the plaintiff does not have to prove fraud. If the representation is false, the directors cannot escape liability even if they had made it *bona fide* and not with intent to deceive. But they have the following special defences under the section.[73]

(*a*) ***Withdrawal of consent.***—A director will not be liable if he had withdrawn his consent to become a director before the issue of the prospectus and the same was issued without his authority or consent.

(*b*) ***Issue without knowledge.***—Even where a director's name appears in the prospectus he can escape liability by proving that it was issued without his knowledge or consent and on becoming aware he forthwith gave a public notice to that effect.

(*c*) ***Ignorance of untrue statement.***—Sometimes a director may be ignorant of the untruth of the statements made in the prospectus. Such a director can defend himself by showing that, on becoming aware of the untrue statement, he withdrew his consent by a reasonable public notice. Obviously, this must be done before allotment.

(*d*) ***Reasonable ground for belief.***—A director will also be protected if he can show that "he had reasonable ground to believe, and did up to the time of allotment believe the statements to be true". It may be recalled that under the rule in *Derry* v *Peek*, a director having honest belief in the truth of his statement is protected. But under this section it is not enough for him to say that he was honest. He must go further and show that his honest belief was based upon reasonable grounds. And so in *Adams* v *Thrift*:[74]

> An action was brought by the plaintiff to recover compensation from a director of a company in respect of false statements in a prospectus. The director contended that the statements were prepared by the promoters

69 The liability is joint and several and the person who becomes liable may recover contribution from others equally guilty of misrepresentation. S. 62(3).
70 S. 65(1)(*a*).
71 S. 65(1) and (6).
72 [1900] 1 Ch 421: [1900] 81 LT 595.
73 S. 62(2).
74 (1915) 2 Ch 21: 113 LT 569 CA.

and before issuing he enquired from one of them, "Is everything perfectly alright" and he said "of course, it is". It was held that although the director did honestly believe the statement to be true, he had no reasonable ground to do so. "The promoter is the very last person whose uncorroborated statement ought to be relied upon by an intending director as justification for saying that he had reasonable ground for belief. If they had taken the opinion or obtained a report of competent people as to material facts in the prospectus that might have afforded a reasonable ground for belief."[75]

(e) Statement of expert.—If the untrue statement happens to be contained in the report of an expert, the director sued has to show that he had reasonable ground to believe and did up to the time of allotment believe that the expert was competent, and if it is in some public official document, that it was a correct and fair representation of the document.

3. Rescission for misrepresentation

An allotment of shares can be avoided at the option of the allottee if it was caused by misrepresentation whether innocent or fraudulent.[76] By avoiding the contract he is able to get rid of his shares and claim the money he paid for them.[77] Further under Section 75 of the Contract Act, a person who lawfully rescinds a contract is entitled to compensation for any damage which he has sustained through the non-fulfillment of the contract. The action is against the company to have the subscriber's name removed from the register of shareholders. The essential requisites of the action are as follows:

(a) False representation

In the first place, there must be a false representation in the prospectus. False representation means a positive misstatement,[78] or a concealment of material facts.[79] But, generally speaking, "a mere non-disclosure does not amount to misrepresentation unless the concealment has prevented an adequate appreciation of what was stated".[80] "Everybody knows that sometimes half a truth is no better than a downright falsehood".[81] *R* v *Kylsant (Lord)*[82] illustrates the point.

Lord Kylsant was prosecuted for issuing a prospectus with untrue statements. A table was set out in the prospectus showing that between

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75 Lord COZENS-HARDY MR, *ibid*. *See* also *Reese River Silver Mining Co. Re*, (1867) 2 Ch 604.

76 S. 18 of the Indian Contract Act

77 S. 64, Indian Contract Act, 1872.

78 S. 18(1), *ibid*.

79 Ss. 18(2), (3) and 17(2), Indian Contract Act.

80 The Explanation to S. 17 of the Indian Contract Act also declares that mere silence is not fraud unless there is duty to speak or silence is, in itself, equivalent to speech. *See* also *Arnison* v *Smith*, (1889) 41 Ch D 348: (1889) 61 LT 63 CA.

81 Lord MACNAGHTEN in *Glucksteln* v *Barnes*, 1900 AC 240, 250: 69 LT Ch 385: 82 LT 393: 16 TLR 321: 7 Mans 321.

82 [1932] 1 KB 442: 101 LJ KB 97 (*R* v *Kylsant*), followed in *R* v *Bishirgain*, [1936] 1 All ER 586 CA.

(1911—1927), the company had paid dividends varying from five to eight per cent, except in 1914, when no dividend was paid and in 1926 when a dividend of 4 per cent was paid. This statement created the impression that the company was in a sound financial position; whereas the truth was that during the seven years preceding the date of the prospectus the company had made substantial trading losses and dividends could be paid only by recourse to funds which had been stored up during the war period. The whole prospectus was held to be false, not because of what it stated, but because of what it did not state.

AVORY J relied upon the following statement of Lord HALSBURY in *Aaron's Reefs Ltd* v *Twiss*:[83] "...taking the whole thing together was there false representation? I do not care by what means it is conveyed—by what trick or device or ambiguous language: all these are expedients by which fraudulent people seem to think that they can escape from the real substance of the transaction. If by a number of statements you intentionally give a false impression and induce a person to act upon it, it is not the less false, although if one takes each statement by itself there may be a difficulty in showing that any specific statement is untrue."[84]

Even if those who issued a prospectus were prompted by innocent motives, the subscriber would be entitled to his remedy.[85] Accordingly, a prospectus stating that "more than half the shares have already been sold", when, in fact, only one promoter of the company had signed documents applying for more than half the shares, but had not paid any money and ultimately he took only two hundred;[86] a prospectus stating that "the directors and their friends have subscribed a large portion of the capital and they now offer to the public remaining shares", the fact being that the directors had subscribed only ten shares each;[87] a prospectus stating that "*B* and *M*, two leading businessmen of repute, have agreed to become directors of the company", when they had only expressed their willingness to help the company[88] were all held to be misleading, giving the subscribers the right to rescind.

With these may be contrasted the facts of *Shiromani Sugar Mills Ltd* v *Debi Prasad*.[89]

> Printed in red ink on the cover of a prospectus was the statement that "the managing agents with their friends, promoters and directors have already promised to subscribe shares worth six lakh rupees". But they had taken much less. Yet it was held that this could not be assailed as a

83 1896 AC 273, 281: [1896] 74 LT 794.

84 *See* AVORY, J's judgment at 448, 1932 KB 442. *See* also *Bentley & Co* v *Black*, (1893) 9 TLR 580 CA, where the court said that the prospectus must be taken as a whole to see whether it conveyed a meaning which amounted to a mis-statement of fact, even if each paragraph taken separately contains no mis-statement.

85 *Eaglesfield* v *Marquis of Londonderry*, (1876) 4 Ch D 693.

86 *Ross* v *Estates Investment Co*, (1868) 3 Ch App 682: (1868) 19 LT 61.

87 *Henderson* v *Lacon*, (1867) 17 LT 527: 59 LJ Ch 794: 5 Eq 249.

88 *Metropolitan Coal Consumers' Assn, Re, Karberge* case, (1892) 3 Ch 1: (1892) 66 LT 700.

89 AIR 1950 All 508: (1950) 20 Comp Cas 296: 1950 ALJ 836.

misrepresentation of fact. "The only fact asserted was the existence of promise... and the existence of promise is not falsified by breaking of it."[90]

In the same way where the alleged misrepresentation in a prospectus was the statement that "the company will commence business with six steamships of special tonnage and rate of speed" and at the time of the prospectus the company had no ships and had only contracted for the supply of two ships, this was not a misrepresentation there being nothing to show that the ships of the specified character might not at any time be purchased in the market.[91]

Sometimes an ambiguous statement is put forward bearing two different meanings, one of which is true and the other untrue. A case of this kind is *Smith* v *Chadwick*.[92]

> The prospectus of a company which was being formed to take over certain iron works contained the statement that "the present value of the turnover is £ 1,000,000 sterling per annum". If the statement meant that the works had actually in one year turned out produce worth more than a million, it was untrue. If, on the other hand, it meant that works were capable of turning out that amount of produce, it was true. It was held that "if they put forth a statement which they knew may bear two meanings one of which is false to their knowledge and thereby the plaintiff putting that meaning on it is misled, they cannot escape by saying 'he ought to have put the other'."

A misreading of the prospectus will not, however, entitle a purchaser of shares to rescission.[93]

Change of circumstances.—There is often an interval of time between the publication of a prospectus and the allotment of shares. During this interval a statement which was true when made may cease to be so owing to some change of circumstances. For example, in *Rajagopala Iyer* v *South Indian Rubber Works*:[94]

> The plaintiff had applied for shares in a company on the basis of a prospectus containing the names of several persons as directors. But before the allotment took place, there were changes in the directorate, some directors having retired. That was held sufficient to entitle the plaintiff to revoke his application as few matters are more important than the names of directors. "Moreover, the persons who applied for shares on the faith of one state of things should have the option of retiring when a totally different state of things came into existence."[95]

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90 DESAI J at 512, *ibid*; see also *Bansidhar Durgadatta* v *Tata Power Co*, (1925) 27 Bom LR 330.

91 *Hallows* v *Fernie*, 3 Eq 520: (1868) 3 Ch App 467.

92 (1884) 9 CA 187: [1881-5] All ER Rep 242: 50 LT 697.

93 MACLEOD CJ in *Bansidhar* v *Tata Power Co*, (1925) 27 Bom LR 330 at 337.

94 [1942] 2 MLJ 228: AIR 1942 Mad 656. *See* also *Vankataramayya* v *Indian Industrial Bank*, AIR 1930 Mad 325: 124 IC 193.

95 MALINS VC in *Scottish Petroleum Co, Re, Anderson* case, (1881) 17 Ch D 373, 375: 50 LJ Ch 269: 43 LT 723: 29 WR 372.

(*b*) *Of facts and not of law*

Secondly, the misrepresentation must be of facts and not of law. If, for example, a prospectus represents that the company's fully paid shares will be issued at half their nominal price, when the Companies Act prohibits the issue of shares at so much discount,[96] it is a misrepresentation of law and a person deceived by it will have no remedy. Again, the facts misrepresented must be material to the contract of taking shares. Materiality of misrepresentation is a question of fact in each case.[97] Generally speaking, a fact is said to be material if it is likely to influence the decision of an average purchaser of shares, that is, if it will urge or induce him to purchase or refrain from purchasing shares. This rule enables the directors to include what are commonly known as 'flourishing or puffing up statements' and make the prospectus attractive, as was done, for example, in *Mckeown* v *Boudard Peveril Gear Co Ltd.*[98]

> A company was incorporated for working inventions of one Boudard relating to the driving gear of cycles. Its prospectus stated: "Within a few weeks the following exciting, and at the time unheard of, performances took place." Then the results of various cycle races were set out in all of which the company's cycle was claimed to have bettered the record and the prospectus concluded with these words: "This is the first occasion that a mile has been done under two minutes in England. Every rider to whom speed is an object will be bound to have it. What cycle riders are there who will buy slow machines when one admittedly faster is there in the market." All the records set out in the prospectus were indeed true. But the plaintiff complained on the ground that the prospectus did not disclose that they had already been beaten at the time of the prospectus.

It was held that the omission of later performances which had outdone the records referred to in the prospectus was not material and did not render the prospectus misleading. "It is impossible to suppose that the plaintiff could have been really deceived by such a common quality in the prospectus as puffing or that he was blind to the possibility that the records and the performances set forth might possibly be due not solely to the merits of the gear, but also to the merits and skill of the riders and to the general improvement in cycles."

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96 S. 79.

97 For illustrations of material misrepresentation see *Metropolitan Coal Consumers' Assn, Re, Karberge* case, [1892] 3 Ch 1: (1892) 66 LT 700, where LINDLEY LJ said that "few matters are more material than the names of the first directors. What is a prospectus worth without the names of good men upon it"; *Wimbledon Olympia Ltd, Re,* [1910] 1 Ch 630: 102 LT 425, where the omission to disclose the state of previous mortgages was held to be a material misrepresentation; *Coal Economising Gas Co, Re,* (1875) 1 Ch 182, where the meaning of material contracts is explained; *State* v *Red Grande Rubber Estates Ltd,* 1913 AC 853 and *Pacaya Rubber & Produce Co,* [1914] 1 Ch 542, in both of which there were material inaccuracies in reports included in the prospectus; *Russian Vyksounsky Iron Works Co, Re,* (1866) 1 Ch App 574: (1866) 15 LT 817, objects misstated.

98 (1896) LT 310: 65 LJ Ch 735.

(c) *Reliance and inducement*

It is further necessary that the plaintiff should have acted in reliance on the statements contained in the prospectus. Misrepresentation should be at least one of the inducements for his contract of taking shares. It is for this reason that a purchaser of shares in the open market cannot proceed against the company[1] unless the company had done something to induce him to purchase in the market.[2] For the same reason a person cannot complain of misrepresentation if "he had the means of discovering the truth with ordinary diligence".[3] But a recipient of a prospectus is entitled to rely on it. He is not bound to verify it. Explaining this in a case, the House of Lords observed[4]:

> But the appellants say that even admitting the prospectus to be open to the objections which are made to it, the respondent has no ground of complaint, because he had an opportunity of ascertaining the truth of the representations contained in it, of which he did not choose to avail himself, that he was told by the prospectus that the "engineer's report together with maps, plans and surveys of the line, might be inspected, and any further information obtained, on application at the temporary offices of the company"; and in his letter of application he agreed to be bound by all the conditions and regulations contained in the memorandum and articles of the company, which, if he had examined, would have given him all the information necessary to correct the errors and omissions in the prospectus.
>
> But it appears that when once it is established that there has been any fraudulent misrepresentation or wilful concealment by which a person has been induced to enter into a contract, it is no answer to his claim to be relieved from it to tell him that he might have known the truth by proper inquiry.

(d) *By or on behalf of company*

"A company is not responsible for the statements in a prospectus unless it is shown that the prospectus was issued by the company or by someone with the authority of the company — by the board of directors, for instance,[5] or that the prospectus, having been issued by the promoters was ratified by the company.[6]

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1 *Hyslop* v *Morel*, (1891) 7 TLR 263; *Peek* v *Gurney*, (1873) 43 LJ Ch 19: [1861-73] All ER Rep 116: LR 6 HL 377.

2 *Andrews* v *Mockford*, (1896) 1 QB 372: (1896) 73 LT 726.

3 In *Mohun Lall* v *Sri Gungaji Cotton Mills Co.* (1900) 4 CWN 369, the prospectus was issued in May and shares were allotted in November. The Court, therefore, held that between these dates there was ample time and opportunity to find out whether Mr Campbell who was represented to be a provisional director had actually consented to be a director. The Court applied the exception to S. 19 of the Contract Act.

4 *Director of Central Rly Co* v *Kisch*, (1867) LR 2 HL 99. 36 LJ Ch 849: 16 LT 500: 15 WR 821.

5 Palmer's, COMPANY LAW, 165 (20th Edn, 1959). See *Metal Constituents Ltd, Re, Lord Lurgan* case, [1902] 1 Ch 707: (1880) 86 LT 291, where a misrepresentation was made before incorporation and the company was held not liable.

6 *National Exchange Co of Glasgow* v *Drew*, (1855) 2 Macg 124: 25 LT SO 223; *Houldsworth* v *City of Glasgow Bank*, (1880) 5 App Cas 317: (1880) 42 LT 194 HL.

This becomes particularly important where a representation is made apart from prospectus. Thus where a person was induced to join a company as a shareholder by representations of the secretary of the company, he could not obtain rescission as the secretary has no general authority to make representations.[7] But where shares were applied for on the basis of fraudulent representation made by a person both before and after he had become a director, rescission was allowed.[8]

Limits of recission and loss of right

A contract induced by misrepresentation is valid until it is rescinded. The option to rescind is not an unlimited one. It is lost in the following circumstances.

(*a*) *By affirmation*

If the allottee, with full knowledge of misrepresentation, upholds the contract, he cannot afterwards rescind. Affirmation may be express or implied. An implied affirmation takes place by the shareholder's conduct, where, for example, after discovering his right to rescind, he endeavours to sell his shares, attends meetings of the company, receives dividends or pays calls.[9]

(*b*) *By Unreasonable Delay*

"Any man who claims to retire from a company on the ground that he was induced to become a member by misrepresentation, is bound to come at the earliest possible moment after he becomes aware of the misrepresentation."[10] Accordingly in *Christineville Rubber Estates Ltd, Re,*:[11]

> An applicant to whom shares were allotted in a company became fully aware of misrepresentation in the prospectus by the end of July, but in December he moved to have his name removed from the register. It was held that the unexplained delay of five months precluded him from obtaining relief.[12]

(*c*) *By Commencement of Winding Up*

The right of rescission is lost on the commencement of winding up of the company. Shareholders cannot be permitted to get rid of their shares after the

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7 *Diwan Chand* v *Gujranwala Sugar Mills,* AIR 1937 Lah 644. *See* also *Mohun Lall* v *Gungaji Cotton Mills Co,* (1900) 4 CWN 369.

8 *Hilo Mfg Co* v *Williamson,* (1911) 28 TLR 164 CA. A stranger, which means a person who has not invested any money in the company on the faith of the prospectus, has no right to start a public interest litigation against the company on the ground that it has published a misleading prospectus. *Kisan Mehta* v *Universal Luggage and Mfg Co,* (1988) 63 Comp Cas 398 Bom.

9 *Briggs, ex p,* (1866) LR 4 Ch App 332; *Sharpley* v *South and East Coast Rly Co,* (1876) 2 Ch D 663; *Scholey* v *Central Rly,* (1868) LR 9 Eq 266; *Dunlop Truflault Cycle & Tube Mfg Co, Re,* (1896) 66 LJ Ch 25: (1896) 75 LT 385; *Deposit Life Assurance Co* v *Ayscough,* (1856) 119 ER 1048.

10 *London & Staffordshire Fire Insurance Co, Re,* (1883) 24 Ch D 149: 48 LT 955.

11 (1911) 81 LJ Ch 63: 106 LT 260.

12 *See* also *Madrid Bank, Re,* (1867) 2 Ch App 536; *Jagannath Prasad, Re,* AIR 1938 All 193: 1938 ALJ 94: 174 IC 886; *Shiromani Sugar Mills* v *Debi Prasad,* AIR 1950 All 508, DESAI J at 513 1950 ALJ 836: (1950) 20 Comp Cas 296.

proceedings for the winding up of the company have been initiated. The names of the shareholders are entered in the register of members and the register is *prima facie* evidence of membership. It is open to public inspection. "The object being that the creditors might form their own opinion as to the person who constituted the shareholders of the company."[13] Creditors might have lent money on the faith of so many good names being there on the register. And if the shareholders can get their names removed from the register even after the winding up is on, the creditors would be seriously misled.[14] "But where a shareholder has started active proceedings to be relieved of his shares, the passing of the winding up order during their pendency would not prevent his getting the relief."[15]

4. Liability under Section 56

Section 56(1) states that a company's prospectus must contain certain particulars and sub-section (3) imposes penalty for its contravention.[16] But the section is silent as to the subscriber's remedy in case all the required particulars are not disclosed. "The section in terms gives no remedy or cause of action; but it is a remedial section for the protection of applicants for shares against wiles of promoters and others."[17] The provision does contemplate a liability in damages on the part of directors and other persons responsible for prospectus, for sub-section (4) exonerates such persons from liability if they can prove certain matters.[18] That is equivalent to saying that they are liable if they cannot prove those defences. Hence an allottee can recover damages from the directors for mere failure to comply with Section 56(1). But the plaintiff who has subscribed for shares on the faith of a prospectus which did not disclose the material particulars required to be disclosed by the section must prove that he has sustained damage. The onus lies on him to show that he has acted on the faith of the prospectus, that is to say, if he had known of the undisclosed matter he would not have become a shareholder.[19] It should be noted that the section does not entitle a shareholder to get rid of his shares by reason merely of the omission of any of the facts required to be disclosed by the section.[20] Where, however, the omission amounts to fraud or misrepresentation within the meaning of Sections 17 and 18 of the Indian Contract Act, an action for rescission will also lie.

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13 *First National Reinsurance Co Ltd* v *Greenfield*, [1921] 2 KB 260: 1920 All ER Rep Ext 777.

14 LORD CAIRNS in *Cachar Co, Re*, (1867) 2 Ch App 412; *Tennent* v *City of Glasgow Bank*, (1879) 4 App Cas 615: 40 LT 674: 27 WR 649 HL.

15 DESAI J in *Shiromani Sugar Mills Ltd* v *Debi Prasad*, AIR 1950 All 508, 513: 1950 ALJ 836: (1950) 20 Camp Cas 296: *See* also *Jagannath Prasad, Re*, AIR 1938 All 193: 1938 ALJ 94: 174 IC 886.

16 Which may extend to five thousand rupees.

17 Lord LINDLEY in *Macleay* v *Tait*, 1906 AC 24, 28.

18 See DESAI J in *Shiromani Sugar Mills Ltd* v *Debi Prasad*, AIR 1950 All 508, at 512: 1950 ALJ 836: (1950) 20 Comp Cas 296; *South of England Natural Gas & Petroleum Co, Re*, (1911) 1 Ch 573: 80 LJ Ch 358: 104 LT 378; *London Assn* v *Mansel*, (1879) 11 Ch D 313.

19 *Twycross* v *Grant*, (1877) 2 CPD 469 CA: 46 LJ QB 636: 36 LT 812: 25 WR 701 CA.

20 *Shiromani Sugar Mills Ltd* v *Debi Prasad*, AIR 1950 All 508: 1950 ALJ 836: (1950) 20 Comp Cas 296; *Coal Economising Gas Co, Re*, (1875) 1 Ch 182: *Wimbledon Olympia, Ltd, Re*, (1910) 1 Ch 630: 102 LT 425. *See* NEVILLE J at 632.

A director or other person sued under this section may defend himself by showing[21]—

1. that he had no knowledge of the matter not disclosed;[22]
2. that the contravention arose out of an honest mistake of fact;[23]
3. if, in the opinion of the Court, the matter not disclosed was immaterial or that the person sued ought to be excused.[24]

Criminal liability for misrepresentation [S. 63]

Where a prospectus includes any untrue statement, every person who authorised the issue of the prospectus shall be punishable with imprisonment for a term which may extend to two years, or with fine which may extend up to fifty thousand rupees or with both.[25] A director prosecuted under this section can defend himself by showing that the statement was immaterial or he had reasonable ground to believe and did up to the time of the issue of the prospectus believe that the statement was true.[26] A company's prospectus stated that the company had the experience in its line of business of two and a half decades. The experience was, infact, that of the partners of a firm which had been taken over by the company and not, that of the company itself. The court granted relief against any possible liability. There was no *mala fide* intention behind the statement. The management was successful. The statement was not so materially false as to invite prosecution.[27]

Invitation for deposits [S. 58-A]

The Central Government has taken the power by Section 58-A to regulate, in consultation with the Reserve Bank, the acceptance of deposits by companies. Such rules may prescribe for the limits up to which, the manner in which and the terms and conditions on which deposits may be invited or accepted. Apart from the regulations that may be thus prescribed, the section itself contains certain important provisions. Deposits should be invited in accordance with the deposit rules and by an advertisement accompanied by a statement showing the financial

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21 S. 56(4).

22 For an explanation of the circumstances in which this defence may be resorted to *see* BYRNE J in *Waits* v *Bucknall*, [1902] 2 Ch 628. *See* also *Twycross* v *Grant*, (1877) 2 CPD 469 CA: 46 LJQB 636: 36 LT 812: 25 WR 701 CA, where it was pointed out that the liability would arise under the section even where an omission has been made under *bona fide* belief that it was unnecessary to specify the matter complained of. *See* also *Hoole* v *Speak*, [1904] 2 Ch 732: 91 LT 183, and the proviso to sub-section (4) which states that there shall be no liability for matters specified in cl. 18 of Sch. II unless there was knowledge of the matters not disclosed.

23 *Macleay* v *Tait*, 1906 AC 24.

24 *South of England Natural Gas & Petroleum Co, Re*, [1911] 1 Ch 573: 80 LJ Ch 358: 104 LT 378. The administration of the power under this section is vested in SEBI, S. 55-A.

25 *Srinivasan* v *Emperor*, (1944) MWN 312 and *R* v *Kylsant*, [1932] 1 KB 442: 101 LJ KB 97.

26 *See also* sub-section (2) which excludes from liability under the section a person who has given consent under S. 58 or S. 60. See *R* v *Kylsant*, [1932] 1 KB 442: 101 LJ KB 97; *R* v *Bishirgain*, (1936) 1 All ER 586 CA. The power of prosecution under the section has been delegated to the Securities and Exchange Board of India (SEBI).

27 *Progressive Aluminium Ltd* v *Registrar of Cos*, (1997) 89 Comp Cas 147 AP: [1997] 4 Comp LJ 215.

position of the company in such form as may be prescribed by the rules.[28] If any deposit is accepted or renewed in contravention of such rules, the company shall repay it within thirty days or within further thirty days if allowed by the Central Government on sufficient cause. Where a deposit is not refunded in accordance with its terms and conditions, the Company Law Board may order repayment. It may do so on its own motion or on the application of the depositor. The Board may extend the schedule for repayment. In *Pure Drinks (New Delhi) Ltd Re*,[29] the Company Law Board did not authorise reduction in rate of interest. The Board may take into account the interest of the company, that of the depositor and also public interest. The Board may require refund either in full or in part and subject to such conditions and within such time as the order may prescribe. The company and any interested person should be given an opportunity of being heard.[30]

If the deposit is not so refunded the company shall be liable to a fine twice the amount of the deposit not refunded. Out of this amount, when realised, the court pays back the depositor and then the company's liability stands discharged. Officers are punishable with fine and imprisonment not exceeding five years.[31]

Deposits in excess of the limits prescribed by the rules also involve fine on the company to an amount equal to the deposit; for mere invitation the fine may go up to ten lakh rupees, but not less than Rs 50,000. Officers are punishable with fine and imprisonment up to five years.

No company can invite deposits or renew them if it is in default in the repayment of any deposits in full or in part or any interest due on them.[32]

These provisions are not applicable to a banking company, or a company which the Central Government may, in consultation with the Reserve Bank, exempt; any other financial company which the Central Government may similarly exempt, but not from the requirement as to advertisement.[33] The *Explanation* appended to the section defines the term "deposit" as any deposit of money including any amount borrowed by the company, but excluding

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28 Private Companies cannot advertise for deposits. When a private company accepts deposits from its members or directors, it has to take a declaration from them that they are not making deposit out of the borrowed money. *Vijay Kumar Gupta* v *Eagle Paint & Pigment Industries P Ltd*, (1997) 26 Corpt LA 236 CLB.

29 (1995) 83 Comp Cas 174 CLB.

30 Disobedience of the orders of the CLB under S. 58-A(8) is punishable under sub-section (9). *Thapar Agro Mills Re*, (1997) 25 Corpt LA 102 CLB, rescheduling at 2% higher interest rates. *Modern Denim Ltd, Re*, (1998) 28 Corpt LA 210 CLB, rescheduling.

31 The aggrieved person can make an application at the quarters of the Company Law Board at New Delhi, 110 001; Calcutta, 700 001; Madras, 600 006; Bombay, 400 038. [Press Note of Deptt of Company Affairs, 1/6/88. CL U of 29-8-1989.]

32 This restriction has been introduced by the Companies (Amendment) Act, 1996 (w.e.f. 1-3-1997).

33 Sub-s. (7). The exemption is also there in favour of deposits for booking vehicles, and those accepted by financial companies like hire-purchase, housing, investment, loan-mutual benefit financial companies, an equipment leasing company, a chit fund company, such industrial companies (as may be prescribed) and relief undertakings.

In addition to the relief under the Companies Act, the depositor can also proceed under the normal civil law of the country.

categories of amounts which may be prescribed by the Central Government in consultation with the Reserve Bank.

Acceptance and repayment of deposits

Of late, companies have shown a marked preference for raising funds by inviting fixed deposits from public generally instead of raising capital by means of a prospectus. There is a greater desire to raise loan capital instead of share capital. The craze began for the reason that no sanctions were necessary initially in inviting deposits and no regulations had to be followed in subsequently maintaining them. People were tempted to invest because higher interest rates were offered as compared with banks. Some investors had, however, to face a very sad experience. Unscrupulous companies failed to pay back and the deposit-holders had no effective remedy. There was a wave of public disappointment with companies. The Government intervened. The Companies Act was amended. Sections 58-A and 58-B came into being. They regulate public invitation for deposits, their acceptance and repayment and also provide criminal sanctions for breach of rules. Section 58-B provides that the provisions of the Act relating to prospectus shall, as far as may be, apply to an advertisement for deposits. Every person who at the time of any contravention of the provisions was in responsible position in the company shall be guilty and punishable.[34] The Madras High Court witnessed a case arising out of prosecution under the section.[35] The provisions of the section and the rules framed under it by the Reserve Bank of India prescribe the maximum extent to which a company can receive deposits. There is a criminal sanction against violation of the ceiling. The deposits received by a company were in excess of the permitted amount at the time when the section was enforced. The section required refund of the excess amount within thirty days. The company did not do so but instead renewed such deposits for further periods. This entailed prosecution. The company, its managing director and the directors who were brought on record wanted the proceedings to be quashed till their application to the Central Government for exemption from the operation of the section was disposed of and also on the ground that the section should apply only to the acceptance of fresh deposits and not to the renewal of existing ones, because the word "renewal" does not figure in the

34 See *RBI* v *Dhanlakshmi Funds*, (1987) 60 Comp Cas 439 Mad, where the partners of an erstwhile firm, which was taken over by a company, were held liable for contravention of the provisions; *Chennai Bolting Co* v *Asstt ROC*, (1987) 61 Comp Cas 770 Mad, lenient punishment where deposits were repaid after breach.

35 *Sujani Textiles P Ltd* v *Asstt ROC*, (1980) 50 Comp Cas 276 Mad; *Jagjivan Ram Hiralal Doshi* v *ROC*, (1989) 65 Comp Cas 553 Bom: [1989] 2 Comp LJ 315, 328 Bom. The magistrate taking cognizance of an offence under the section also enjoys the power of recalling cognisance and without trying it there it would be premature to apply to the High Court for quashing the proceedings. *Ramakrishna Flour and Besan Mills P Ltd* v *Company Registrar, MP*, (1994) 79 Comp Cas 528 MP. Following *Mathew K.M.* v *State of Kerala*, (1992) 1 SCC 217: (1992) 1 Ker LT 1 SC, the court below, if satisfied, had jurisdiction to recall the order of cognisance and to drop proceedings.

section. These arguments were not accepted. The prosecution was directed to proceed. The court said:

> "Instead of repaying the excess amount, the petitioners have kept the amount and have issued fresh deposit receipts. This renewal amounts to receiving fresh deposits. The word "renew" also means "to acquire again". Therefore renewal amounts to receiving fresh deposits within the meaning of Section 58-A(4) punishable under Section 58-A(5)(*b*). Since the punishment under the Section is for more than three years, and also fine, the prosecution is not barred by reason of the provisions of Section 468-C of the Criminal Procedure Code."

Whenever new regulations of this kind are brought into being curbing the earlier freedom of action, some default in their implementation may creep in and no punishment is deserved if the default is made good as soon as it is pointed out. The Calcutta High Court adopted this approach in a case where the company readily rectified the default.[36] The company in this case was the famous East India Hotels Ltd. The company's deposits exceeded the prescribed limits. The company applied to the Government of India seeking exemption. The Department of Company Affairs expressed their inability to do so. The company immediately covered the deposits by securing them by creating a trust. The company then prayed for relief against the penal consequences. The Registrar opposed the company. The court allowed relief. The company had made good the default by giving security to the depositors. No depositor had made any complaint against the company which made it reasonable to suppose that they had accepted the security. There was no further violation of Section 58-A and its rules. Thus relief was fully deserved.

One of the rules promulgated by the Government[37], Rule 3-A requires a company to deposit or invest a sum equal to at least 10 per cent of the amount maturing during the year in certain specified accounts in a scheduled bank or in specified securities, which should not be subjected to any charge or lien. Some of the affected companies challenged the validity of the rule. The Supreme Court rejected the petitions.[38] Ten per cent of the amount maturing every year is

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36 *East India Hotels Ltd, Re*, (1980) 50 Comp Cas 381 Cal, where a prosecution was commenced under the section for receiving excess deposits at a time when only S. 58(B)(5)(*a*) and (*b*) of the Reserve Bank of India Act, 1934 was in force. The Madras High Court quashed the proceeding because S. 58-A(5)(*a*) and (*b*) of the Companies Act provide for a different and greater punishment. *Sun Paper Mill Ltd* v *Asst Registrar of Companies*, (1986) 59 Comp Cas 320 Mad. For another similar case see *S. Thiagarjan* v *Asstt Registrar of Companies*, (1986) 59 Comp Cas 328 Mad.

37 Under the rule making power conferred by S. 58-A read with S. 642 of the Companies Act. Deposit Rules formulated by classifying financial companies in one category of residuary non-banking companies have been held to be valid. *Peerless General Financial and Investment Co Ltd* v *RBI*, (1992) 2 SCC 343: (1992) 75 Comp Cas 12 SC. *See also* SEBI Guidelines for companies rendering financial services, SEBI Rules and Regulations for Mutual Funds and Asset Management Cos and Rules and Regulations for Portfolio Managers, 1993.

38 *Delhi Cloth and General Mills* v *UOI*; *Arvind Mills* v *UOI*; *Madhusudan Veg Products* v *UOI*; *Modi Spg and Wvg Mills* v *UOI*; *Goetze (India) Ltd* v *UOI*, (1983) 4 SCC 166: (1983) 54 Comp Cas 674: (1983) Tax LR 2584. The decision of the Madras HC in *P. Subramaniam* v *RBI*, (1985) 57 Comp Cas 755 is to the same effect. The Karnataka High Court allowed relief under S. 633(2) by directing the Registrar not to prosecute for violation

required to be kept in a free deposit as a measure of protection of the depositors. The deposit will accumulate into a sizable amount. The depositors will be able to get their refund surely. There is nothing inherently wrong with the scheme. The fact that the Government had the power to exempt some companies from the requirement did not make the power arbitrary unless there was arbitrary use of it. The Court, however, conceded that companies have a right to go in for writs against violation of the right to equality or fundamental freedoms as enshrined in Article 19.[39]

In case of default in repayment of deposit money or payment of interest, the Tribunal[40] (formerly CLB) may, on the application of the depositor, order repayment. The Tribunal can do so on its own motion also.

The orders of the Company Law Board (now Tribunal) are enforceable through the civil court in the manner of a court decree.[41]

Duty to small depositors [S. 58-AA]

This new provision has been introduced by the Amendment of 2000. If a company fails to pay back a small depositor, it has to inform the National Company Law Tribunal accordingly. A small depositor means a depositor who has in a financial year deposited with the company not more than Rs 20,000.[42] The information has to be submitted on monthly basis within 60 days of each default and with all the particulars of the deposit. The default may be for the whole amount or a part of it or in respect of interest. On receipt of such information, the NCLT is under a duty to exercise the power under Section 58-A(9) to order the company to pay back the depositor. The NCLT may pass such an order of its own motion within 30 days. After such period, it may do so under

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of S. 58-A because by the time the show-cause notice was given, the directors had already rectified the default. *G. M. Mohan* v *ROC*, (1984) 56 Comp Cas 265. Failure to fulfil this requirement has been held to be one-time offence attracting the six months' bar of limitation under S. 468, CrPC 1973; failure to repay is a continuing offence, *Sivandhi Adityam* v *Addl ROC*, (1995) 83 Comp Cas 616 Mad.

39 The court was of the view that the judicial attitude has changed since the *Bank Nationalisation* case, (1970) 1 SCC 248: (1970) 40 Comp Cas 325 SC. The offence of non-payment is not of continuing nature. Subsequent directors are not liable for earlier defaults. *Assit ROC* v *R. Narayanaswamy*, (1985) 57 Comp Cas 787. Fundamental rights are not violated by deposit rules. *A. S. P. Aiyer* v *RBI*, (1984) 56 Comp Cas 352 Mad. The duty to file a return as to deposits continues even after the time for filing the return has expired and the default being of continuing nature, penalty proceedings cannot be barred by limitation. *U.P. Paper Corpn P Ltd* v *ROC*, (1987) 61 Comp Cas 728 Cal. It has been held that different ceilings for individuals, firms and companies are not violative of Art. 14 of the Constitution. *Kanta Mehta* v *UOI*, 62 Comp Cas 769 Del. The return must be in reference to the latest audited balance-sheet of the company. *Malayala Manorma Co Ltd* v *ROC*, (1990) 69 Comp Cas 339 Ker. The auditor's remark in his certificate that there was a non-compliance with deposit rules was held to be *prima facie* evidence for framing a charge of violation. *Mohan Lal Rathi* v *Addl ROC*, [1992] 1 Comp LJ 207 Del. *Carrier Savings & Investments India Ltd* v *UOI*, (2002) 110 Comp Cas 631 (Raj), the company applied for permission for retaining deposits beyond maturity period. The Government passed an order without considering representation of the company. Violation of natural justice. The court ordered for rehearing of the matter.

40 *Substituted* for CLB by the Second Amendment Act, 2002.

41 *Edpuganti Bapanaiah* v *Nagarjuna Finance Ltd*, (2002) 111 Comp Cas 496 CLB.

42 S. 58-AA, *Explanation*. Depositor includes his successors, nominees and legal representatives.

intimation to the depositor but his presence at the hearing for an order is not necessary.

Such a defaulting company cannot accept any further deposit from small depositors unless it has paid back the whole amount due to each and every such depositor. This disability is not to apply in respect of a deposit which has been renewed by the depositor voluntarily or where repayment could not be made due to the death of the depositor or stay order of a court or some other authority.

The total amount of default in respect of small deposits has to be included in future advertisement and application forms inviting public deposits. Where interest accruing to small depositors has been waived, this fact should also be included in the advertisement and application forms.

Where after acceptance of new deposits, the company has been successful in taking loans for its working capital, before such loan amount is used for any other purpose, it should be applied in repayment of dues on small deposits. Application forms must inform future small depositors of past defaults in repayment of principal or waiver of interest.[43]

On the abolition of the Company Law Board by enforcement of the Second Amendment Act, 2002, the powers of CLB would become vested in National Company Law Tribunal (NCLT) or (Tribunal).

Fraudulently inducing investment of money [S. 68]

It is a punishable offence to fraudulently induce persons to invest money in companies. The penalty of the section is attracted when investment is brought about by knowingly or recklessly making any statement, promise or forecast which is false, deceptive or misleading or by any dishonest concealment of material facts. Liability would be incurred even when one is only attempting to do so. The object of the inducement is to bring about any agreement for acquiring, disposing of or subscribing for or underwriting any shares or debentures or bringing about profit from fluctuations in the value of shares or debentures.[44]

First issue in demat form [S. 68-B]

The Amendment of 2000 has added this new section. It provides that every listed public company, making initial public offer of securities of Rs 10 crore or more, shall issue the same in dematerialised form. For this purpose the requirements of the Depositories Act, 1996 and Regulations made under that Act should be complied with.

Vesting of Powers in SEBI [S. 55-A]

This provision was added by the Amendment of 2000 (w.e.f. 13-12-2000) for vesting of powers in SEBI in respect of the power under the following

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43 Default committed knowingly in not complying with the provisions or in carrying out the orders of the Company Law Board entails punishment by way of imprisonment extending to three years or daily fine of not less than Rs 500. Directors and the company are deemed to be guilty. In other respects S. 58-A applies. The offences under the section have been made cognizable when complaint is made by the Central Government or its authorised functionary. S. 58-AAA.

44 Administration of power under the section has been vested in SEBI.

sections: Ss. 55 to 58; Ss. 59 to 84; 108, 109, 110, 112, 113, 116, 117, 118, 119, 120, 121, 122, 206, 206-A, to the extent to which these provisions relate to issue and transfer of securities, and non-payment of dividend.

The operation of this section is restricted to listed companies and those which are proposed to be listed. In other respects the powers are to be exercised by the Central Government or Tribunal or the Registrar of Companies, as the case may be.

6
Promoters

Definition and importance

In many company matters, the term "promoter" is of frequent occurrence. The Companies Act itself uses the word at some places for the purpose of imposing liability upon promoters.[1] Yet "it has never been clearly defined either judicially or legislatively".[2] "The difficulties in defining the term led the judges to state that the term 'promoter' is not a term of art, nor a term of law, but of business."[3] The emphasis upon its business implication is quite apparent from the statement of BOWEN LJ that the term is used to sum up "in a single word a number of business operations, familiar to the commercial world, by which a company is generally brought into existence".[4] Most of the definitions are in terms of categories of work that promoters usually perform. "A promoter is a person who brings about the incorporation and organisation of a corporation. He brings together the persons who become interested in the enterprise, aids in procuring subscriptions, and sets in motion the machinery which leads to the formation itself."[5] "A promoter is one who undertakes to form a company with reference to a given project and to set it going, and who takes the necessary steps to accomplish that purpose."[6] The term, therefore, "has no very definite meaning".[7] Whether a person is a promoter or not is a question of fact in each case. Much depends upon the nature of the role played by him in the promotion of business. In *Twycross* v *Grant*,[8] the court said "that the defendants were the promoters of the company from the very beginning can admit of no doubt. They framed the scheme, they not only provisionally formed the company, but were, in fact, to the end its creators, they found the directors, and qualified them, they prepared the prospectus, they paid for printing and advertising, and the expenses incidental to bringing the undertaking before the world." The court added that

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1 For example, Sections 62, 69 and 478 impose liability upon promoters. "Before a company can be formed there must be some persons who have the intention to form a company, and who take the necessary steps to carry that intention into operation. Such persons are called 'promoters'." Charlesworth and Morse, COMPANY LAW, 98 (14th Edn, 1991).

2 Joseph H. Gross, *Who is a Company Promoter*, (1970) 86 LQR 493.

3 *Id.*, at 506.

4 *Whaley Bridge Calico Printing Co* v *Green*, (1880) 5 QBD 109: 28 WR 351 : 41 LT 674.

5 *Bosher* v *Richmond Land Co.* 89 Va 455 (16) SE 360 : 37 Am St Rep 879. Collected from Canfield and Wormser, CASES ON PRIVATE CORPORATIONS.

6 COCKBURN CJ in *Twycross* v *Grant*, [1877] 2 CPD 469, 541 : 46 LJ QB 636 : 36 LT 812: 25 WR 701 CA. This definition was adopted by the Mad HC in *Weavers Mills* v *Balkis Ammal*, AIR 1969 Mad 462 at 468-69 : [1969] 2 MLJ 509: ILR [1969] 1 Mad 433.

7 LINDLEY, J, in *Emma Silver Mining Co* v *Lewis*, (1879) 4 CPD 396, 407: 40 LT 749; followed in *Thiruvenkatachariar National Livestock Registration Bank Ltd* v *A. T. Velu Mudaliar*, ILR 1938 Mad 192: AIR 1938 Mad 154. The advantage of having a flexible definition is that only those would be subjected to the strict duties of a promoter who fulfil the functional concept of the definition. *Jacobus Marler Estates Ltd* v *Marler*, (1913) 85 LJPC 167.

8 (1877) 2 CPD 469 CA: 46 LJQB 636: 36 LT 812: 25 WR 701 CA.

the functions of promoters come to an end as soon as they hand over the company to a governing body, like a board of directors.[9]

A person who acts in a professional capacity is not a promoter. Thus a solicitor, who prepares on behalf of the promoters the primary documents of the proposed company, is not a promoter.[10] Similarly, an accountant or a valuer who helps the promotion in his professional capacity is not a promoter. The Companies Act, in Section 62, while providing for the liability of a promoter for misrepresentation in prospectus, also excludes such a person from the category.[11] But any such person may become a promoter if he helps the formation of the company by doing an act outside the scope of his professional duty. A person may, for example, help in getting a purchaser for the company's patent, or of shares, or in getting personnel for the company. Any such role may make him a promoter.[12]

DUTY AND LIABILITY

Fiduciary position

The position of promoters in relation to the company was explained by Lord CAIRNS in *Erlanger* v *New Sombrero Phosphate Co*[13] in the following words:

> They stand, in my opinion, undoubtedly in a fiduciary position. They have in their hands the creation and moulding of the company. They have the power of defining how and when, in what shape and under what supervision the company shall start into existence and begin to act as a trading corporation.

The business of promotion thus gives a very advantageous position to the promoter in relation to the proposed company. The courts have, therefore, fixed him with the responsibility of a fiduciary agent. "The promoter is in the situation akin to that of a trustee of the company, and his dealings with it must be open and fair." [14] Thus the first and the foremost duty of a promoter is that if

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9 A person may become a promoter even after the formation of the company, for example, by becoming party to share issues or to procuring subscriptions. Section 62 makes liable for misstatements in prospectus every person who is promoter of the company. Stringent provisions of the Companies Act and of the allied Acts have virtually eliminated fraudulent practices in company promotions.

10 A servant or agent of a promoter is not to be regarded as a promoter for that reason alone; also a solicitor doing only legal work, *Great Wheal Polgooth Ltd, Re*, (1883) 53 LJ Ch 42.

11 Sub-section (6) of the section says "For the purpose of this section—(*a*) the expression 'promoter' means a promoter who was a party to the preparation of the prospectus ... containing the untrue statement, but does not include any person by reason of his acting in a professional capacity for persons engaged in procuring the formation of a company."

12 A person who leaves the task of promotion to others and sits behind to share their profits is likely to be regarded as a promoter. *Emma Silver Mining Co* v *Lewis*, (1879) 4 CPD 396: 40 LT 749 and *Tracy* v *Mandalay*, (1952-53) 88 CLR 215.

13 (1878) 3 App Cas 1218 at 1236: 48 LJ Ch 73: 39 LT 269: 27 WR 65. The Madras High Court has accepted this position of promoters in *Weavers Mills* v *Balkis Ammal*, AIR 1969 Mad 462: [1969] 2 MLJ 509: ILR [1969] 1 Mad 433. The basic element in the duty is something that needs no saying, namely, their duty is to promote the interests of the company.

14 Morawetz, CORPORATION, Section 546. *Omnium Electric Palaces Ltd* v *Baines*, (1914) 1 Ch 332 CA, they are not trustees in the real sense of the word because the company may not be in existence as a legal person. Fiduciary position emerges from agency.

he starts a company for the purpose of buying his property and wants to draw his payment from the money obtained from shareholders, he must faithfully disclose all facts relating to the property. If he conceals any fact in relation to the character or value of the property, or his personal interest in the proposed sale, the company will be entitled to set aside the transaction or recover compensation for its loss. He is guilty of breach of trust if he sells property to the company without informing the company that the property belongs to him or he may commit a breach of trust by accepting a bonus or commission from a person who sells property to the company. In short, the chief duty of the promoter as a fiduciary agent is to disclose to the company his position, his profit and his interest in the property which is the subject of purchase or sale by the company.[15]

The only difficult question is to whom the disclosure is to be made. It was suggested by the House of Lords in *Erlanger* v *New Sombrero Phosphate Co*[16] that it should be made to an independent and competent board of directors. The facts of the case were as follows:

> A group of persons headed by *E* purchased an island containing phosphate mines for £ 55,000. A company was then incorporated to take over the island and to work the mines. *E* named five persons as directors. Two were abroad. Of the three others, two were persons entirely under *E's* control. These three directors purchased the island for the company at a price of £ 1,10,000. A prospectus was then issued. Many persons took shares. The purchase of the island was adopted by the shareholders at their first meeting; but the real circumstances were not disclosed to them. The company failed and the liquidator sued the promoter for refund of the profit.

The only material contention urged on behalf of the promoter was that the company's board of directors had full knowledge of the facts. Rejecting this Lord CAIRNS said:

> If they (promoters) propose to sell their property to the company, it is incumbent upon them to take care that they provide the company with an executive body who shall both be aware that the property which they are asked to purchase is the promoter's property and who shall be competent and impartial judges as to whether the purchase ought or ought not to be made. They should sell the property to the company through the medium of a board of directors who can and do exercise an independent and intelligent judgment on the transaction.[17]

Subsequent experience, however, showed that it may not always be possible for the promoters to give to the company an independent board of directors. In the case of a private company, or a public company which, like that of Saloman & Co, consists of only the family members, it is just not possible to constitute an independent board of directors. In such a case the promoter should disclose his

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15 There is no duty that the promoter must restrain himself from making any profit whatsoever in the business of promotion. *Omnium Electric Palaces Ltd* v *Baines*, (1914) 1 Ch 332 CA.

16 (1878) 3 App Cas 1218: 48 LJ Ch 73: 39 LT 269: 27 WR 65.

17 *Id.*, at 1223.

interest and profit to the shareholders of the company. But it will not be enough to disclose the truth to the first few shareholders. The disclosure should be made to the whole body of persons who are invited to become the shareholders. This was emphasised by the House of Lords in their well-known decision in *Gluckstein* v *Barnes*.[18]

> A syndicate of persons was formed to raise a fund, buy a property, called "Olympia" and resell it to a company. They first bought up some of the charges upon the property for sums below the amount which the charges afterwards realised, and thereby made a profit of £ 20,000. They bought the property for £ 1,40,000, formed a limited company and resold the property for £ 1,80,000 to the company, of which they were first directors. They issued a prospectus inviting applications for shares and disclosing the two prices of £ 1,40,000 and £ 1,80,000 but not the profit of £ 20,000. Shares were issued but the company afterwards went into liquidation.

It was held that the promoters ought to have disclosed to the company the profit of £ 20,000. The defendant, who was one of the promoters, contended that the fact was known to the parties to the transaction. Rejecting this, HALSBURY LC said:

> It is too absurd to suggest that a disclosure to the parties to this transaction is a disclosure to the company. They were there by the terms of the agreement to do the work of the syndicate, that is to say, to cheat the shareholders; and this, forsooth, is to be treated as a disclosure to the company, when they were really there to hoodwink the shareholders, and so, far from protecting them, were to obtain from them the money, the produce of their nefarious plans.[19]

Disclosure is not the most appropriate word to use when a person who plays many parts announces to himself in one character what he has done and is doing in another.[20]

The duty continues even after incorporation until the profits are fully disclosed and fully accounted for.[21]

Where rescission is not possible, that is, the company is not in a position to return the property, it can recover damages for breach of the duty of good faith, though the measure of damages is the profit which the promoter made from the breach of his duty.[22]

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18 1900 AC 240: 69 LJ Ch 385: 82 LT 393: 16 TLR 321: 7 Mans 321.

19 1900 AC 240 at 247. *See* also *Postage Stamp Automatic Delivery Co, Re*, [1892] 3 Ch 566: 61 LJ Ch 597: (1892) 67 LT 88; *Promoters Profits: Control by Court & Commission*, (1936) 59 Harv LR 785.

20 Lord MACNAGHTEN, *ibid.*

21 *Emma Silver Mining Co* v *Lewis*, (1879) 4 CPD 396: 40 LT 749. Subject to such disclosures, it is quite lawful for a promoter to sell his property to the company at a profit to himself. *Omnium Electric Palaces Ltd* v *Baines*, (1914) 1 Ch 332 CA. He is bound to disclose his profit only minus the expenses in earning the same, *Lydney and Wigpool Iron Ore Co* v *Bird*, (1886) 33 Ch D 85 CA.

22 *Leeds & Hanley Theatres of Varieties Ltd, Re*, [1902] 2 Ch 809: 72 LJ Ch 1: 87 LT 488. *See*, generally, Joseph Gold, *The Liability of Promoters for Secret Profits in English Law*, (1943-44) 5 Toronto LJ 21 and J. H. Cross, COMPANY PROMOTERS, Tiagidim Publishing House, 1972.

The Companies Act now requires through Section 56 the promoters' earnings to be disclosed in the prospectus itself. The disclosure has to be made of the amount paid within the last two years or to be paid to the promoters of the company. The statement has to include any other benefit also. Disclosure has also to be made of any interest of the promoter in the promotion of the company or in any property acquired by the company during the two years or proposed to be acquired.[23]

A leasehold interest was purchased by a promoter for a company which he intended to form. However, he first formed a partnership firm and then converted it into a company. It was held that the interest in the lease became the property of the company without any formality of conveyance. From the very first day of purchase it became in equity the property of the company.[24]

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23 *See* clause 11 of Part C of Part II of the Second Schedule.

24 *Vali Pattabhirama Rao* v *Ramanuja Ginning and Rice Factory P Ltd*, (1986) 60 Comp Cas 568 AP. In addition to all these obligations, the promoters have to comply with SEBI Guidelines, 1992 relating to their contribution to the public issue and lock-in-period.

7

Shares

ALLOTMENT

Offers for shares are made on application forms supplied by the company. When an application is accepted, it is an allotment.[1] "What is termed 'allotment' is generally neither more nor less than the acceptance by the company of the offer to take shares."[2] "Broadly speaking it is an appropriation by the directors... of shares to a particular person."[3] "It is an appropriation out of the previously unappropriated capital of a company."[4] Consequently where forfeited shares are re-issued, it is not the same thing as an allotment.[5]

A valid allotment has to comply with the requirements of the Act and principles of the law of contract relating to acceptance of offers.

Statutory restrictions on allotment

1. *Minimum Subscription and Application Money* [S. 69]

The first requisite of a valid allotment is that of minimum subscription. When shares are offered to the public, the amount of minimum subscription has to be stated in the prospectus. Minimum subscription means the amount which is, in the estimate of the directors, enough to meet the following needs, namely, purchase price of any property to be defrayed partly or wholly out of the proceeds of the issue, preliminary expenses and working capital (not to be less than 90% of the whole issue offered to the public, as now prescribed)[6]. No shares can, be allotted unless at least so much amount has been subscribed and the application money, which must not be less than five per cent of the nominal value of the share, has been received in cash.[7]

A number of cases have established that it is a condition precedent to valid allotment that the whole of the application money should have been paid to and

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1 See *Sri Gopal Jalan & Co* v *Calcutta Stock Exchange Assn*, AIR 1964 SC 250, 251: 33 Comp Cas 862. Reaffirmed by the Supreme Court in *Gopal Paper Mills* v *CIT*, (1970) 2 SCC 80, 86: AIR 1970 SC 1750; *Associated Clothiers* v *UOI*, ILR [1957] 2 Punj 505, 511-12. The Madras High Court has held in *Shri Ayyanar Spg & Wvg Mills* v *V.V.V. Rajendran*, (1973) 43 Comp Cas 225 Mad, that an oral application for shares is equally valid. But since S. 41 requires an agreement in writing, no allotment can be made without a written application for allotment. *H. H. Manabendra Shah* v *Official Liquidator*, (1977) 47 Comp Cas 356.

2 CHITTY J in *Florence Land & Public Works Ltd, Re*, (1885) 29 Ch D 421, 426, adopted by the Supreme Court in *Sri Gopal Jalan & Co* v *Calcutta Stock Exchange Assn*, AIR 1964 SC 250: 33 Comp Cas 862.

3 STIRLING J in *Spitzel* v *Chinese Corpn*, (1899) 80 LT 347, 351.

4 SARKAR J in *Sri Gopal Jalan & Co* v *Calcutta Stock Exchange Assn*, AIR 1964 SC 250: 33 Comp Cas 862.

5 *Ibid.* Allotment has to be an initial issue. *CIT* v *V.S.S.V. Meenakshi*, (1984) 55 Comp Cas 545.

6 S. 69(1) and clause 5 of Schedule II.

7 S. 69(3). Cash means actual cash received whether by means of cheque, draft or otherwise. An application accompanied by cash of more than Rs 20,000 (then permissible Income Tax Act limit for cash payments) was held to be rightly rejected, the mode of payment being illegal, *Mohammed Rafeek* v *SEBI*, (1999) 98 Comp Cas 802.

received by the company in cash.[8] Any means by which money can be remitted may be used, but remittances must be cleared and actual cash received by the company before proceeding to allotment. An application for shares, if not accompanied by any such payment, does not constitute a valid offer.[9] Further, it has been held that an allotment of shares made without the application money being paid is invalid and the directors are guilty of misfeasance.[10]

> The object of these provisions, says Gower, is to prevent the company getting under way until it has raised the capital needed to carry out the objects in which it has invited the public to participate; it would obviously be iniquitous to force an applicant, who has accepted an invitation to participate in a one million issue for the purpose of buying Wembley Stadium, to sink his capital in a company which has only raised enough money to buy a suburban villa. They also afford protection to the creditors by ensuring that a limited company is not able to incur commitments if it is grossly under-capitalised.[11]

If the minimum subscription has not been received within 120 days of the issue of the prospectus, the money received from the applicants must be repaid without interest.[12] If the money is not paid back within 130 days the directors become personally liable for it with interest, unless they can show that the default was not due to any negligence or misconduct on their part.[13]

2. *Statement in lieu of Prospectus* [S. 70]

Where prospectus has not been issued, no allotment shall be made unless at least three days before a statement in lieu of prospectus has been filed with the Registrar.[14]

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8 *See*, for example, *Nears* v *Western Canada Pulp & Paper Co*, [1905] 2 Ch 353; *National Motor Mail-Coach Co, Re*, [1908] 2 Ch 228: [1908-10] All ER Ext Rep 1373; *Malabar Iron & Steel Works Ltd, Re*, AIR 1964 Ker 311. *Universal Incast Ltd* v *SEBI*, (2002) 108 Comp Cas 248 P&H, the application money has to be kept in a separate bank account with the bankers to the issue and not in any bank of the company's choice. The money must remain there till all the mandatory requirements are complied with and the company can proceed to make allotment. Where the company did not do so even after receiving orders from the SEBI (Authority), the Stock Exchange was held to be justified in refusing to list the company's securities.

9 *Ramlalsao Gupta* v *M.E.R. Malak*, AIR 1939 Nag 225: ILR 1941 Nag 567: 183 IC 748.

10 *Indian States Bank Ltd* v *Kunwar Sardar Singh*, AIR 1934 All 855: 154 IC 33.

11 THE PRINCIPLES OF MODERN COMPANY LAW at 300 (3rd Edn, 1969).

12 S. 69(5). The investors can make use of the new commercial instrument, namely, stockinvest scheme under which their application money remains with their own bank and is collected by the company only if some shares are allotted to the applicants.

13 The rate of interest is 6% per annum. A director may, however, defend himself by showing that he was not guilty of any negligence or misconduct. S. 69(5). The minimum subscription prescribed under the rule making power is 90% subscription against the entire issue offered to the public. F 21/14/CCI/90 of 6-4-1990. The applicants cannot waive this right [Sub-sec (6)]. Sub-s. (3) [application money] will apply to subsequent issues by the company also but not the whole of the section. Sub-s. (4) requires that the moneys received from the applicants shall be kept in a Scheduled bank and not withdrawn till certificate for commencement of business is received.

14 S. 70(1). Jenkins Committee recommended repeal of provision relating to statement in lieu of prospectus. *See* paras 235-252(6).

An allotment made in contravention of the above two rules is voidable at the instance of the applicant, provided he moves within two months of the statutory meeting of the company or where statutory meeting is not required to be held or where the allotment is made after the holding of the statutory meeting, within two months after the date of the allotment.[15] Notice of avoidance given within this time will be sufficient, though actual legal proceedings, if necessary, may be commenced thereafter.[16] It is not necessary that the allottee should commence actual legal proceedings within two months. It is enough for him to give a notice to the company of his intention to revoke the allotment. Such an allotment is voidable even if the company is in the course of winding up.[17]

Where the contravention is wilful, the directors guilty thereof are liable to compensate both the allottee and the company, provided that the party suing has sustained a loss and brings the action within two years of the allotment.[18]

3. *Opening of Subscription list* [S. 72]

Shares cannot be allotted at once after the issue of the prospectus. Section 72 enjoins that no allotment shall be made until the beginning of the 5th day from the date of the issue of the prospectus. This is known as the time of opening of subscription list. The directors may extend this time by a statement to that effect in the prospectus, but it cannot be cut short. The validity of an allotment is not affected by any contravention of this section, although a penalty is imposed on the company and its officers.[19] Applications for shares are not revocable until the end of the 5th day from the opening of the subscription list.[20]

4. *Shares to be dealt in on Stock Exchange* [S. 73]

Every company intending to offer shares or debentures to the public by the issue of a prospectus has to make an application before the issue to any one or more of the recognised stock exchanges for permission for the shares or debentures to be dealt with at the exchange. The amendment of 1988 has made an application to a stock exchange compulsory. Formerly it was optional with the company.[21] It is a condition precedent for listing permission that the application money is deposited in a separate bank account.[22]

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15 S. 71(1). *Finance & Issue Ltd* v *Canadian Produce Corpn*, (1905) 1 Ch 37: 73 LJ Ch 751: 91 LT 685.

16 *National Motor Mail-Coach Co, Re*, (1908) 2 Ch 228: [1908-10] All ER Ext Rep 1373.

17 S. 71(2).

18 S. 71(3).

19 S. 72(3). Penalty may extend to fifty thousand rupees. Where any person responsible under S. 62 for any statement in the prospectus has given a public notice excluding his liability, 5th day for opening subscription list would be counted from the date of such notice [sub-s.(1) proviso].

20 S. 72(5).

21 This is known as listing. Stock Exchanges charge their fee for listing agreements. Provisions of Securities (Contracts Regulation) Act, 1956 are applicable to the subject. Government guidelines on the subject are also there.

22 S. 69(4) and S. 73(3). *Universal Incast Ltd* v *AA SEBI*, [2000] CLC 948 P&H.

An allotment shall become void if the permission has not been granted before the expiry of ten weeks from the date of the closing of the subscription list.[23]

If the allotment becomes void under this section, the money received from the applicants shall be forthwith repaid.[24] If it is not refunded within 8 days, the directors will be personally liable to repay it with interest.[25]

The object of Section 73 has been explained by the Supreme Court in *Union of India* v *Allied International Products Ltd.*[26] The object of the provision is to enable shareholders to find a ready market for their shares so that they can convert their investment into cash whenever they like. The Supreme Court held that even if one out of the several stock exchanges applied for and granted recognition it would be sufficient to validate the allotment; the facility of at least one stock exchange would thereby be available.[27] The amendment of 1974 nullified this part of the judgment. Now the position is that if, out of the stock exchanges applied for, a single stock exchange refuses to grant listing, the allotment, if already made, becomes void. The company may appeal to the Central Government. If the appeal is successful, the decision of stock exchange is set aside and the listing would be granted. The allotment would be saved.[28] Where a stock exchange failed to

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23 Ten weeks are to be reckoned from the closure of the subscription list and not from the date of allotment even if earlier. *Raymond Synthetics Ltd* v *UOI*, (1992) 2 SCC 255: (1992) 73 Comp Cas 1: AIR 1992 SC 847: [1992] 1 Comp LJ 209. The period of ten weeks cannot be extended by the court on the ground of injunction against public issue, *Unjha Formulations Ltd* v *Unjha Pharmacy*, (1996) 2 Guj LH 511.

24 Since the money lies in a separate bank account, it is refundable to allottees even if the company is in winding up. *Nanwa Gold Mines Ltd, Re*, [1955] 1 WLR 1080, 1085. Refund orders are required under Government prescription to be sent by registered post.

25 S. 73(2). The amendment of sub-section (2) in 1988 provides that the company and every officer of the company who is an officer in default shall on and from expiry of the 8th day be jointly and severally liable to repay that money with interest at such rate, not less than 4% and not more than 15% as may be prescribed. The following rates of interest has been prescribed w.e.f. 21-2-1992: The rates of interest, for the purposes of sub-s. (2) and (2-A) shall be 15% per annum. (GSR No 312E of 6-3-92).

The subscription money has been held to be in the nature of trust money and not a part of the banker's general assets so as to be usable in his insolvency. It is refundable *in specie*. *Reserve Bank of India* v *BCCI (Overseas) Ltd*, (1993) 78 Comp Cas 230 Bom. Misuse of the money may amount to criminal breach of trust and punishable as such under the Indian Penal Code, 1860. Power of prosecution has been delegated to SEBI. *Radhey Shyam Khemka* v *State of Bihar*, (1993) 3 SCC 54: (1993) 77 Comp Cas 356 SC. The offence involved in failure to despatch was held to be wiped out where as soon as the failure was discovered, the default was made good by sending duplicate refund warrants, *Herdillia Unimers Ltd* v *Arun Bansal*, (1999) 96 Comp Cas 521 Raj.

26 (1970) 3 SCC 574: (1971) 41 Comp Cas 127. The advantage of listing is that shares become freely marketable and this enhances their value.

27 *See* the observation of the learned judge explaining the vital role stock exchanges have played in the economic development of a nation (*ibid* at 132).

28 *Rishyashringa Jewellers Ltd* v *Stock Exchange, Bombay*, (1995) 6 SCC 714: (1996) 85 Comp Cas 479: AIR 1996 SC 480; *Rich Paints Ltd* v *Vadodra Stock Exchange Ltd*, (1998) 15 SCL 128 Guj. Followed in *Jaltrang Motels Ltd* v *UOI*, (1999) 95 Comp Cas 339, the refundable money was invested in purchasing land, the court directed attachment of the land and deposit of a sum of money with SEBI.

dispose of the company's application and the Central Government, on appeal, ordered listing, the allotment was saved.[29]

The first sub-section of Section 73 was completely changed. The sub-section requires the name of the stock exchange or exchanges to which an application for permission has been made to be specified in the prospectus itself. The second change is that if any such stock exchange has not granted its permission, or has not disposed of the application within ten weeks,[30] the allotment shall become void, even if some other exchanges have granted the permission. The third change is in reference to time. Formerly, an application had to be disposed of within four weeks, which could have been extended by the exchange to seven weeks. Now the time is that of ten weeks from the date of the closing of the subscription list.[31] Where an appeal has been preferred under Section 22 of the Securities Contracts (Regulation) Act, 1956 against the refusal of a stock exchange, the allotment does not become void until the dismissal of the appeal.[32]

Over-subscribed prospectus **[S.73(2-A)].**—Where the permission of a stock exchange has been granted and, therefore, the allotment completed is valid, the prospectus being over-subscribed, the over-subscribed portion of the money received must be sent back to the applicants forthwith. The margin is only that of eight days from the completion of the allotment. A failure to do so would create a liability which has been thus stated: "The company and every officer of the company who is an officer in default shall, on and from the expiry of the 8th day, be jointly and severally liable to repay that money with interest at such rate not less than 4% and not more than 15%, as may be prescribed, having regard to the period of delay in making the repayment of such money".[33]

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29 *Urmila Bharuka* v *Coventry Spring and Engg Co Ltd*, (1997) 88 Comp Cas 197 Cal. Another litigation arising out of the same case is *Urmila Bharuka* v *UOI*, (1999) 97 Comp Cas 97 Cal. One of the effects of the refusal is that the Stock Exchange can ask the company to delete its name from the company's prospectus, *Lunkad Mehta & Entertainment Ltd* v *Stock Exchange, Mumbai*, (2000) 39 CLA 267 SAT.

30 S. 73(5).

31 *UOI* v *Allied International Products*, (1971) 41 Comp Cas 116 at 120-121. The amendment leaves the section in essence as it was before.

32 S. 73(1), proviso. The procedure for appeals is prescribed by Appeal to Central Government Rules 1993. Rules and Regulations have also been prescribed for Registrars to Issue and Transfer Agents. The listing is done in accordance with the rules framed under the Securities (Contracts Regulation) Act, 1956. The rules and requirements of the Stock Exchange have to be complied with. Listing particulars are required to be published in the prospectus. A listing agreement has to be entered into.

Brokers at stock exchanges may not accept unlisted securities. For the convenience of investors in new and small companies an Over the Counter Exchange of India (OTCEI) has been established which provides liquidity facilities to such investors.

33 A flat rate of 15% has been prescribed w.e.f. 21-2-92. According to S 74 the days specified above have to be exclusive of public holidays. The default under the section has been held to be an offence of a continuing nature. *Ghanshyam Chaturbuj* v *Industrial Ceramics (P) Ltd*, (1990) 68 Comp Cas 36 Mad. The default under S. 73(2-A) which attracts interest with refund money due has been held by the Supreme Court to be not a penalty but a method of calculating the refundable amount, but the default under sub-s. (2-B) is a penalty. *Raymond Synthetics Ltd* v *UOI*, (1992) 2 SCC 255: (1992) 73 Comp Cas 762 SC: AIR 1992 SC 847: [1992] 1 Comp LJ 209. Management of issues is in the hands of Merchant Bankers. They have to function under SEBI Rules and Regulations for Merchant Banking. No interest is payable if refund is made in time, *J. S. Sodhi* v

Section 74 provides guidance as to the manner in which the fifth, eighth or the tenth day for the purposes of Sections 72 and 73 are to be reckoned.[34]

General principles

An effective allotment has to comply with the requirements of the law of contract relating to acceptance of an offer.[35]

1. *Allotment by proper authority.*—In the first place, an allotment must be made by a resolution of the board of directors. "Allotment is a duty primarily falling upon the directors", and this duty cannot be delegated except in accordance with the provisions of the articles. Accordingly, an allotment made by a general manager under an improper delegation by the directors was held to be void.[36] But where the articles so provided, an allotment made by secretaries and treasurers was held to be regular.[37]

2. *Within reasonable time.*—Secondly, allotment must be made within a reasonable period of time, otherwise the application lapses. What is reasonable time must remain a question of fact in each case. The interval of about six months between application and allotment has been held to be not reasonable. On the expiry of reasonable time Section 6 of the Contract Act applies and the application must be deemed to have been revoked.[38]

3. *Must be communicated.*—Thirdly, the allotment must be communicated to the applicant. Posting of a properly addressed and stamped letter of allotment is a sufficient communication even if the letter is delayed or lost in the course of post.[39] *Household Fire and Carriage Accident Insurance Co* v *Grant*[40] is the leading authority.

C. T. Scan Research Centre P Ltd, (1995) 83 Comp Cas 762 P&H, following *Pritam Singh Batra* v *Deol Agro Oil Ltd*, (1995) 82 Comp Cas 685 P&H. A default under the section is a continuing offence, *Bausch & Lamb India Ltd* v *ROC*, (2000) 38 CLA 13 Delhi.

34 The section is as follows: Manner of reckoning fifth, eighth and tenth days in Sections 72 and 73.—In reckoning for the purposes of Ss 72 and 73, the fifth day, [or eighth day] after another day, any intervening day which is a public holiday under the Negotiable Instruments Act, 1881 (26 of 1881), shall be disregarded, and if the fifth, [or eighth day] (as so reckoned) is itself such a public holiday, there shall for the said purposes be substituted the first day thereafter which is not such a holiday.

35 S. 72(1)(*b*) specially provides that the provisions of the section will not have the effect of affecting any liability under the general law.

36 *Bank of Peshawar Ltd* v *Madho Ram*, AIR 1919 Lah 351: 51 IC 812.

37 *Pasurala Sanyasi* v *Guntur Cotton, Jute & Paper Mills Co*, AIR 1915 Mad 325: 26 IC 349.

38 *Ramlalsao Gupta* v *M. E. R. Malak*, AIR 1939 Nag 225: ILR 1941 Nag 567: 183 IC 748. Where an application was made in December and accepted in August—allotment was held to be too late. *See* also *Ramsgate Victoria Hotel Co* v *Montefiore*, (1866) 1 Ex 109, application in June, allotment in November, held invalid; *Radhe Shyam Beopur Co Ltd* v *Prabhu Dayal*, AIR 1936 Lah 16; *Indian Coop Navigation & Trading Co Ltd* v *Padamsey Premjit*, (1933) 36 Bom LR 32, in both of which allotment was delayed for a whole year and was held void.

39 *Dunlop* v *Higgins*, 1 HLC 381. *See* Sections 4, 5 and 6 of the Indian Contract Act, 1872.

40 (1879) 4 Ex Div 216: 48 LJ Ex 597: 41 LT 298: 27 WR 858. According to the Indian Contract Act, 1872 acceptance becomes binding on the offeror when the letter of acceptance is posted to him so as to be out of power of the acceptor, (S. 4). An application may be withdrawn before the letter of allotment is posted and in that case the applicant will not be bound by the allotment. See *National Savings Bank Assn, Re*, (1867) 4 Eq 9. Allotment letters are required under Government prescription to be sent to allottees by registered post.

The defendant grant applied for some shares in the plaintiff company. His application was sent by post and a letter of allotment was despatched by the company soon after. But the letter never reached the applicant. He was nevertheless held liable as a shareholder.

4. *Absolute and unconditional.*—Allotment must be absolute and in accordance with the terms and conditions of the application, if any. Thus where a person applied for 400 shares on the condition that he would be appointed cashier of a new branch of the company, the Bombay High Court[41] held that he was not bound by any allotment unless he was so appointed.[42] A condition which is to operate subsequently to allotment will not affect its validity. An applicant to whom shares were allotted on the condition that he would pay for them only when the company paid dividends was held to be bound even though the company had gone into liquidation before paying any dividend.[43]

The applicant must promptly reject the allotment when shares have been allotted to him without his condition being fulfilled. An acquiescence on his part would amount to a waiver of the condition. Thus where a shareholder accepted or pledged his shares, he was held to have lost his right to insist on the condition in his application.[44]

Certificate of shares [S. 113]

An allottee of shares is entitled to have from the company a document, called share certificate, certifying that he is the holder of the specified number of shares in the company. Accordingly, every company making an allotment of shares or debentures or debenture-stock is obliged to deliver to the allottee a certificate of shares, etc., within three months after the allotment.[45] In the case of a transfer, the certificate has to be delivered within two months. The Central Government[46] may grant an extended period of not more than 9 months. If a company makes a default in this respect, the allottee or transferee may give a notice to the company reminding it of its obligation and, if the default is not made good within ten days of the notice, the allottee can apply to the Central Government for a direction to the company to issue share certificates in accordance with the Act.[47] The delivery must be effected in accordance with Section 53 of the Act.[48]

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41 *Ramanbhai* v *Ghasiram*, ILR (1918) 42 Bom 595; *Mutual Bank of India* v *Sohan Singh*, AIR 1936 Lah 790.

42 *See* further *Monarch Insurance Co. Re*, (1873) 8 Ch App 507.

43 *Motilal Chunilal* v *Thakorlal*, (1912) 14 Bom LR 648.

44 *Hargopal* v *People's Bank of Northern India Ltd*, AIR 1935 Lah 691.

45 The section is not applicable to issue of bonds. *Mahanagar Telephone Nigam Ltd, Re* [1993] 3 Comp LJ 239 CLB. The requirement prescribed by the Department for uniform size certificates has been withdrawn. The prescription was under the Companies (Issue of Share Certificate) Rules, 1960.

46 *Substituted* for CLB by the Second Amendment of 2002.

47 S. 113(3); sub-section (2) imposes penalty for default. The Calcutta High Court had held in *Asiatic Oxygen Ltd, Re*, (1972) 42 Comp Cas 602; AIR 1972 Cal 50 that the only obligation of the company was to keep the certificates ready for delivery, but the court could not compel the company to actually deliver them. The decision was contrary to *Burdett* v *Standard Exploration Co.* (1899) 16 TLR 112, on the basis of which it was observed in Palmer's COMPANY LAW at 307 (20th Edn, 1959) that "the right to a certificate can be enforced by

A consequential amendment to the section introduced by the Depositories Act, 1996 provides that where shares are dealt with in a depository, the company has to intimate the details of the allotment to the depository immediately on such allotment. Shares in a depository record would not have to be given their distinctive numbers.

The right of an allottee to get his certificate cannot be defeated by putting up the right of lien for any dues owed by the allottee to the company. Lien is not exercisable against the responsibility to issue certificates to allottees.[49]

A complaint was allowed to be filed at a place other than the company's registered office. The court was of the view that the trade in securities was taking place throughout the country and that trade would be defeated if a complaint could be filed only at one place.[50] The Supreme Court has laid down that a complaint would lie only at the place of the company's registered office.[51] The jurisdiction under the section allows only the recovery of share certificates and not compensation for any losses caused by the delay in getting the certificate.[52]

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action against the company". The amendment of 1988 has made it a positive duty of the company to deliver. See *PNB Mutual Fund* v *MS Shoes East Ltd*, (1998) 16 SCL 627 CLB, the company directed to deliver debenture certificates.

48 This section requires service by post or by personal delivery.

49 *Trishla Jain* v *Oswal Agro Mills Ltd*, (1996) 86 Comp Cas 48 CLB.

50 *Ranbaxy Laboratories Ltd* v *Indra Kala*, (1997) 88 Comp Cas 348 Raj. The company had failed to register a debenture transfer and to issue new certificate. The issue of process against the company and defaulting directors was upheld. *Hindustan Development Corpn Ltd* v *Kushal Chand Bader*, [1998] 1 Comp LJ 110: (1998) 29 Corpt LA 222 Raj. The mere fact that the company has appointed transfer agents and authorised them to carry out the transfer work does not give immunity to the company from its responsibility. The company, its transfer agents, directors and other officers were allowed to go in for compounding. *Herdilia Unimers Ltd* v *Renu Jain*, (1995) 4 Comp LJ 45 Raj; *Reliance Industries Ltd, Re*, (1997) 89 Comp Cas 67 and 465 CLB.

51 *H.V. Jayaram* v *ICICI Ltd*, (2000) 99 Comp Cas 341: (2000) 2 SCC 202: AIR 2000 SC 579. Followed in *Zee Telefilms Ltd* v *State of AP*, (2002) 110 Comp Cas 884 AP, which followed another Supreme Court decision to the same effect in *Jayaram (H.V.)* v *ICICI*, (2002) 99 Comp Cas 341 SC.

52 *Harish Kumar Agarwal* v *Punjab Communications Ltd*, (1998) 28 Corpt LA 249 CLB. *Hindustan Development Corpn Ltd* v *Kushal Chand Bader*, (1998) 29 Corpt LA 222 Raj: [1998] 1 Comp LJ 110, the Special Magistrate (Economic Offences) at Jaipur was held to have jurisdiction to entertain a complaint against a Calcutta based company. The complainant purchased debentures in the open market and applied to the company to register him as a debenture holder. The company failed to do so within the statutory period. *Natvarlal A. Jani* v *N. N. Jain*, (1998) 29 Corpt LA 415 Guj, the substitution of the word CLB for court in 1988 has not taken away the jurisdiction of the court to entertain complaints for violation of S. 113. Prosecution for an offence under the section can be launched before a Magistrate and not before the CLB. *Nestle India Ltd* v *State*, [1999] 4 Comp LJ 446 Delhi, the transferee is an aggrieved person for the purposes of a complaint, the period of limitation commences from the date of the commission of the offence, namely failure to deliver in time. A complaint made after two years after that was held to be time-barred. The Supreme Court held in *Registrar of Companies* v *Rajendra Sugars & Chemicals Ltd*, (2000) 6 SCC 133: (2000) 101 Comp Cas 271: AIR 2000 SC 1643 that the Registrar is an aggrieved person within the meaning of S. 113(2) and, therefore, competent to file a complaint. Follwed in *Indian Petro Chemicals Corpn* v *State of Rajasthan*, (2001) 104 Comp Cas 285 (Raj), *Dhirubhai H. Ambani* v *Sonia Sethi*, (2001) 106 Comp Cas 486 (MP), notice issued to the vice-president of the company, he was bound to honour the court summons and was not allowed to say that he had nothing to do with the offence. *State of Maharashtra* v *Raymonds Woollen Mills Ltd*, (2002) 111 Comp Cas 847

Object and effect of share certificate [S. 84]

Section 84 speaks in plain language of the object of a share certificate. "A share 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." Thus, the share certificate being *prima facie* evidence of title, it gives the shareholder the facility of dealing more easily with his shares in the market. It enables him to sell his shares by showing at once a marketable title.[53]

1. *Estoppel as to title.*—A share certificate once issued binds the company in two ways. In the first place, "it 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."[54] In other words, the company is estopped from denying his title to the shares.

> Suppose *A*, by practising fraud on a company, obtains a share certificate in his name as the holder of some shares. He then sells them in the market. *B*, purchasing them in good faith applied to the company to have the shares registered in his name. The company, having discovered the fraud, refuses. The company must compensate *B* for the loss he has sustained by acting on the faith of the share certificate. The measure of damages would be the market price of the shares at that time.

In a case of this kind:[55]

> The plaintiff applied for 300 shares in a company. A clerk in the company who owned no shares executed a transfer in favour of the plaintiff. The company without requiring the clerk to produce his certificate registered the transfer and issued a new certificate to the plaintiff. The company was held liable to the plaintiff in damages.

2. *Estoppel as to payment.*—Secondly, if the certificate states that on each of the shares full amount has been paid, the company is estopped, as against a bona fide purchaser of the shares, from alleging that they are not fully paid.[56] Thus in *Bloomenthal* v *Ford*:[57]

> *B* lent £1000 to a company on the security of 10,000 shares which were issued to him as fully paid. In fact nothing had been paid on them. In the winding up of the company, it was held that neither the company nor the

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Bom, a complaint against delay in delivering certificates which was filed out of time without application for condonation of delay was not allowed to be entertained.

53 *See* COCKBURN CJ at 595, in *Bahia & San Francisco Rly Co, Re*, (1868) LR 3 QB 584: 18 LT 467. It is necessary for this presumption of prima facie title to operate that the share certificate must have been issued under the company's seal affixed in accordance with the statutory requirements and the company's articles. *Kelapa Sawit* v *Yeoh Kim Leng*, (1991) 1 SCR 415 Malaysia.

54 *Ibid.*

55 *Dixon* v *Kennaway & Co*, [1900] 1 Ch 833: 82 LT 527.

56 *K. Md Farooq Ad* v *Portran Cirkit Electronics P Ltd*, (1997) 25 Corpt LA 209 CLB, a company is completely estopped from denying the amount of payment indicated on the share certificate.

57 1897 AC 156: 76 LT 205.

liquidator could deny that the shares were fully paid and, therefore, *B* could not be placed on the list of contributors.

Where a person knows that the statements in a certificate are not true, he cannot claim an estoppel against the company.[58] But a *bona fide* transferee from him can claim an estoppel.[59] Where shares were issued as fully paid and there was no fraud in the transaction on the part of the holder, the company was held to be under an estoppel as to payment and was not allowed to question it after a long period of time during which the holder had obtained loans on the security of the shares from financial institutions which acted in good faith.[60]

Duplicate certificate [S. 84(2)]

A shareholder is expected to keep his share certificate in safe custody, for he is not entitled to a duplicate unless he shows that the original has been lost or destroyed, or, having been defaced or mutilated or torn, is surrendered to the company. The articles of the company may further require him to give an indemnity bond.[61] Any other terms and conditions may also be prescribed.[62] A civil suit lies for determining ownership of shares and for an order of issue of duplicate share certificates. Civil court jurisdiction becomes barred only in respect of matters for which special jurisdiction has been constituted under the Act.[63]

TRANSFER OF SHARES

"When joint stock companies were established, the great object was that the shares should be capable of being easily transferred."[64] Accordingly, by Section 82 of the Companies Act, it is provided that the shares or debentures or

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58 See *Crickmer* case, (1875) 10 Ch App 614: 46 LJ Ch 870. *American Remedies Ltd* v *Prakash Chandra Gupta*, (2002) 111 Comp Cas 777 CLB. allotment made and entry in share register also made under a stock invest scheme which failed to pay. Transferees of such shares were called upon to pay and certificates were to be issued only to those who paid. Rectification of the register in respect of shares permitted for deleting the name of the allottee.

59 *Barrow* case, (1880) 14 Ch D 432: 42 LT 891 CA.

60 *Farooq Ahmed (K Md)* v *Fortran Cirkit Electronics (P) Ltd*, (1998) 92 Comp Cas 498 CLB.

61 *See* clause 8 of Table A in Sch. 1.

62 S. 84(4). Before passing a mandatory injunction against the company for issuing duplicates, the court should insist upon some proof of the title of the claimant to the shares. *S. Sundaram Pillai* v *P. Govindaswami*, (1987) 62 Comp Cas 414 Mad. Precautions necessary for ascertaining whether the original has been lost must be observed. It could not be said that the original was lost when the company was supposed to know that it was under pledge. The purpose of the provision is to safeguard the market from fraudulent dealings in duplicates. *Tracstar Investments Ltd* v *Gordon Woodroffe Ltd*, (1996) 87 Comp Cas 941 CLB. Affirmed in *Shoe Specialities Ltd* v *Tracstar Investments Ltd*, (1997) 88 Comp Cas 471 Mad. The offence committed by directors in issuing duplicates without precautions was compounded in *Reliance Industries Ltd, Re*, (1997) 89 Comp Cas 67 and 465 CLB. *Inter Sales* v *Reliance Industries Ltd*, (1998) 1 Cal LJ 531 Cal, the matters connected with issue of duplicate securities are not within the jurisdiction of company courts. Companies (Issue of Share Certificates) Rules, 1960, Rule 4(3) is not mandatory. *Rameshchandra Mamtal Kotia* v *State of Gujarat*, (1998) 2 Guj LR 1222, S. 197, IPC would be attracted if the false share certificate would be admissible in evidence without proof. *Suryakant Gupta* v *Rajaram Corn Products (Punjab) Ltd*, (2002) 108 Comp Cas 133 CLB, in the case of a closely held company, an unnatural stand was taken that shares had been despatched to all members. The company was directed to issue duplicates.

63 *Inter Sales* v *Reliance Industries Ltd*, (2002) 108 Comp Cas 680 Cal.

64 BLACKBURN J at 595, in *Bahia & San Francisco Rly Co, Re*, (1868) LR 3 QB 584: 18 LT 467.

other interest of a member in a company shall be moveable property capable of being transferred in the manner provided by the articles of the company.[65] "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."[66] A transfer made with the avowed object of escaping liability was held to be valid in *Discoverers Finance Corpn Ltd, Re,*:[67]

> A holder of partly paid shares, being alarmed at the precarious condition of the company and with a view to escape liability on the shares, sold his shares, to a purchaser in Germany for nominal price, which he never received. The transfers were duly lodged and passed by the Board of directors. It was held that, in the absence of any collusion between him and the directors, the transfers were effective.[68]

Restrictions on transfer (Private Companies)

It is open to a company to restrict the right of its members to transfer their shares.[69] The articles of a private company as against those of a public company contain more rigorous restrictions on the right of its members to transfer shares. This is so because "private companies are (no doubt) in law separate entities just as much as are public companies, but from the business and personal point of view they are much more analogous to partnerships than to public corporations". Accordingly, it is to be expected that in the articles of such a company the control of the directors over the members may be very

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65 The requirements of the articles must be satisfied. Where the articles required that transfer fee and the share certificates must be deposited in the office, court did not compel the company to register a transfer which did not satisfy the requirements and held that depositing them in the court would not do. *Malabar and Pioneer Hosiery P Ltd, Re,* (1985) 57 Comp Cas 570 Ker; *P. V. Chandran v Malabar & Pioneer Hosiery Mill Ltd,* (1990) 69 Comp Cas 164 Ker, followed in *Mathrubhumi Ltd v Vardhman Publishers Ltd,* (1992) 73 Comp Cas 80 Ker: [1992] 1 Comp LJ 234 Ker DB.

66 BENNET J at 238 in *Delavenne v Broadhurst,* [1931] 1 Ch 234: 144 LT 342. Disinvestment of shares by the Government in a public sector company, no interference: employees had no right to demand any percentage, price to employees, no interference: the court directed the Government to device a scheme for effective worker participation in its disinvestment. *Babu Mathew (Prof) v UOI,* (1997) 90 Comp Cas 455 Ker.

67 [1910] 1 Ch 207.

68 To the same effect is *Lindlar* case, [1910] 1 Ch 312, CA. See *Manisha Commercial Ltd v N R Dangre,* (2000) 101 Comp Cas 106 Delhi, the Court refused to stay transfer of shares inspite of the allegation that they were a part of a long-time trust and were, therefore, not transferable. The beneficiary of the trust was seeking transfer in his own name.

69 There is no inherent power of rejection. It would have to be acquired by provisions in the company's constitutional documents. *Luxmi Tea Company Ltd v P. K. Sarkar,* 1989 Supp (2) SCC 656: [1989] 3 Comp LJ 285, 288 SC. The power of refusal based on the company's articles (for not accepting odd lot shares) as required also under the listing agreement was held to be not questionable. *Dipak Kumar Jayantilal Shah v Atul Products Ltd,* (1995) 82 Comp Cas 603 CLB not approved in *Atul Products Ltd v Dipak Kumar Jayantilal Shah,* (1997) 88 Comp Cas 876 Guj.

strict indeed.[70] Moreover, the Act itself requires a private company to impose some restrictions on the right of transfer.[71] Articles requiring that on the insolvency of a member his shares would be transferred at a fair value to a nominee of the directors[72] or that on the death of a member his shares must be offered to the other members have been held to be valid.[73] Articles providing that shares can be transferred to outsiders only if no existing members accept them at face value, are called *pre-emption* clauses. Such a clause does not authorise the directors to refuse to register a transfer so long as it is made to an existing member only.[74] Where no existing member accepts the proposal, transfer in favour of an outsider should be allowed.[75] Articles may contain a clause that the other members will be bound to take shares so offered.[76] The question is in what manner the directors shall exercise this power and to what extent the court or the National Company Law Tribunal can interfere in its exercise. Some of the principles were laid down in *Smith and Fawcett Ltd, Re*.[77]

> A clause in the articles of a private company provided: "The directors may at any time in their absolute and uncontrolled discretion refuse to register any transfer of shares." The issued capital of the company consisted of 8002 shares of which the two directors of the company *S* and *F* held 4001 each. *F* died and his son applied to have the shares registered in his name. But *S*, in the exercise of the above power, refused to consent to the registration. He, however, offered to accept the applicant upto 2001 shares, provided the remaining were sold to him at a fixed price. The plaintiff brought an action contending that *S*'s refusal to register the transfer was on a wrong principle since it was not made for the benefit of the company but was rather to preserve his own dominating position.

It was held that the court would not be justified in interfering in the discretion of the directors. "The directors must exercise their discretion bona fide in what they consider — not what a court may consider — is in the interest of the company." And if they have done that, the court cannot substitute its judgment for theirs.[78]

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70 Lord GREENE MR in *Smith & Fawcett Ltd, Re*, 1942 Ch 304,306: [1942] 1 All ER 542.

71 S. 3(*iii*) provides that "a private company means a company which by its articles restricts the right to transfer its shares...."

72 *Borland's Trustee* v *Steel Bros*, 1901 Ch 279.

73 *Jarvis Motors (Harrow) Ltd* v *Carabott*, [1964] 1WLR 1101, though at the particular moment there was only one other shareholder in the company.

74 *Delavenne* v *Broadhurst*, [1931] 1 Ch 234.

75 *Ocean Coal Co Ltd* v *Powell Duffryn Steam Coal Co*, [1932] 1 Ch 654.

76 See *Rayfield* v *Hands*, [1960] Ch 1: (1958) 2 WLR 851: (1958) 2 All ER 194.

77 [1942] Ch 304: (1942) 1 All ER 542. The principles laid down in this case were cited with approval by the Nagpur High Court in *Balwant Transport Co* v *Deshspande*, AIR 1956 Nag 20, where the court refused to interfere with the director's discretion. *See also* the decision of the Supreme Court in *Harinagar Sugar Mills* v *Shyam Sunder Jhunjhunwala*, AIR 1961 SC 1669: (1961) 31 Comp Cas 387, where all the implications of the power of the Court [now that of CLB] have been elaborately explained.

78 Similar sentiments have been expressed in *Tett* v *Phoenix Property and Investment Co Ltd*, 1984 BCLC 599 at 621, non-interference if the directors' decision was such that a reasonable board could *bona fide* believe it to be in the interest of the company. *Xavier Joseph* v *Indo-Scottish Brand P Ltd*, (2002) 110 Comp Cas 706 CLB, transmission in the case of a closely held company in favour of the son of a deceased member not allowed because he could have

Judicial or Quasi-Judicial Interference in Transfer Matters

In the following circumstances, however, there can be judicial or quasi-judicial intervention:

1. *Mala fide*

Where it is proved that the directors have not exercised their power of refusal in good faith for the benefit of the company. The power of declining a transfer is vested in the Board of directors for the purpose of protecting the interests of the company. Hence their refusal must appear to have proceeded out of an honest desire to benefit the company. A *mala fide* refusal to register a transfer will not be sustained.[79] The National Company Law Tribunal has to decide whether in exercising their power, the directors are acting oppressively, capriciously or corruptly, or in some way *mala fide*.[80]

2. *Inadequacy of reasons*

The practice with the courts was not to ask the directors to supply reasons for their refusal to pass a transfer.[81] But, if they voluntarily disclosed their reasons, the court had the power to look into them and if they did not seem to be sufficient to justify their decision the court might set it aside.[82] Now, by virtue of the amendment of 1988, it has become compulsory to disclose such reasons. This gives an opportunity to the National Company Law Tribunal to examine the relevancy of the reasons and proceed according as the reasons are adequate or inadequate to support the directors' decision.

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caused disharmony. The directors were required to purchase his shares. *Kulveer Chandhoke* v *Eastern Linkers P Ltd*, (2001) 103 Comp Cas 997 Delhi, the High Court decided and the Supreme Court affirmed that the applicant had no title to the shares in question, an application for permission for transfer when the company was in winding up was not allowed.

79 *Gresham Life Assurance Society, Re*, [1972] LR 8 Ch App 446, 452: 28 LT 150; *Coalport China Co, Re*, [1895] 2 Ch 404: [1895-9] All ER Rep Ext 2021; *Bell Bros, Re*, (1981) 65 LT 245: 7 TLR 689. Refusal on the ground that it was necessary to protect the interest of directors is not good, their interest is not equal to that of company or on the ground that there was no consideration for transfer, *Jagdishchandra Champak Lal Parekh* v *Deccan Paper Mills Co Ltd*, (1994) 80 Comp Cas 159 CLB. A refusal on the ground that the transferee was a member of a company which was heavily indebted to the company and that transfer of 4% shares would prejudicially affect the balance of power in the company was not accepted, *Vijaya Commercial Credit Co Ltd* v *T. K. Alwa*, (1994) 79 Comp Cas 656 CLB. As against this an application for 6.84% shares was held to be justifiably refused because it was likely to prejudicially change the composition of the Board of directors. *Gordon Woodroffe Ltd* v *Trident Investment*, (1994) 79 Comp Cas 764 CLB: [1994] 1 Comp LJ 313. Where, the changes apprehended in the Board of Directors had already taken place, refusal on that ground was held to be not good. *Patel Engg Co Ltd* v *Patel Relators P Ltd*, (1992) 74 Comp Cas 395 CLB. These decisions were under S. 22-A of the Securities Contracts (Regulation) Act, 1956. The role of CLB under that Act was explained in *Gammon India Ltd* v *Hong Kong Bank Agency (P) Ltd*, (1992) 74 Comp Cas 123: [1992] 1 Comp LJ 279 CLB.

80 SHAH J in *Harinagar Sugar Mills* v *Shyam Sunder Jhunjhunwala*, AIR 1961 SC 1669, 1675: (1961) 31 Comp Cas 387, quoting from *Bell Bros Ltd, Re*, *See* also *Indian Chemical Products Ltd* v *State of Orissa*, [1966] 2 Comp LJ 64: AIR 1967 SC 253: (1966) 36 Comp Cas 592.

81 *Mathew Michael* v *Teekay Rubbers (India) Ltd*, (1982) Tax LR 2493 Ker: (1983) 54 Comp Cas 88, where the directors had disclosed no reasons and the court expressed its helplessness in the matter.

82 *Ibid. See* also *Mathesan* v *Nath Singh Oil Co Ltd*, 18 JC 481; *Bajaj Auto Ltd* v *Firodia*, (1970) 2 SCC 550: AIR 1971 SC 321: (1971) 41 Comp Cas 1.

3. *Irrelevant considerations*

"The directors (in refusing a transfer) must have regard to those considerations and those only, which the articles on their true construction permit them to take into consideration."[83] A refusal based on extraneous considerations will be wrong.[84] The directors have to specify the grounds on which they have declined a transfer.[85] Refusal by directors on the ground of inadequacy of consideration was held to be not proper.[86]

Thus where the directors were empowered to refuse to register a transferee if it was not in the interest of the company that he should be a member, it was held that a refusal on the ground that the shares were transferred singly or in small amounts and to persons who had no interest in shipping was unjustified.[87] In another case[88], the directors had the power to refuse a transfer of partly paid shares to a person of whom they would not approve. In the exercise of this power they rejected a transfer of fully paid shares on the ground that the transferee had bought them, not so much for investment, as for the purpose of acquiring control of the company. This was held to be unwarranted by the articles. Where the directors of a private company refused to accept a transfer in favour of a company whereas they had power to exclude only undesirable persons, the Calcutta High Court[89] held that such blanket ban on admission of companies was beyond their authority. The court pointed out: "Approval of the transferee means approval of the transferee personally as distinguished from laying down a general rule that no corporate body would be allowed to join the company as a shareholder."[90]

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83 Lord GREENE MR in *Smith & Fawcett Ltd, Re*, [1942] Ch 304, 306: [1942] 1 All ER 542. Refusal on frivolous grounds is not sustainable. *Techno-Electric and Engg Co Ltd* v *Payal Singh*, [1992] 1 Comp LJ 334 Cal. DCA is of the same view. Circular No. 3 of 1993, March 22, 1993. *Standard Chartered Bank* v *Housing and Urban Development Corpn Ltd*, (1996) 23 Corpt LA 84 CLB, no empowerment in articles for refusing registration of transfer of the company's bonds, innocent buyer cannot be prejudiced by private agreements. *Housing and Urban Development Corpn Ltd* v *Standard Chartered Bank*, (1996) 23 Corpt LA 198 (Delhi), restrictions imposed by the controller of Capital Issues were meant to be observed by the company and not by allottees. *Volvo Lastvagnar Komponenter AB* v *Morgardshammar (India) Ltd*, (1998) 30 Corpt LA 382 CLB, private agreements, not incorporated in articles, cannot be used for refusing transfers.

84 *Babulal Choukhani* v *Western India Theatres*, (1958) 28 Comp Cas 565: AIR 1957 Cal 709. A refusal on the ground of an agreement between members not contained in the company's article was held to be wrong. *V. B. Rangaraj* v *V.B. Gopalakrishnan*, (1992) 1 SCC 160: (1992) 73 Comp Cas 201 SC: AIR 1992 SC 45: [1992] 1 Comp LJ 11.

85 *Coimbatore Kamala Mills Ltd* v *T. Sundaran*, (1950) 20 Comp Cas 61 Mad. There is now adverse presumption if they do not do so. *Muthapa Chettiar* v *Salem Rajendra Mills*, (1955) 25 Comp Cas 283: [1955] 2 Mad LJ 535.

86 *Vikas Jalan* v *Hyderabad Industries Ltd*, (1997) 88 Comp Cas 551 CLB.

87 *Bede S S Co Ltd, Re*, [1917] 1 Ch 123: 115 LT 580: 33 TLR 13.

88 *Jalpaiguri Cinema Co Ltd* v *Pramatha Nath Mukherjee*, (1971) 41 Comp Cas 678 Delhi. *See* also *South Indian Bank Ltd* v *Joseph Michael*, (1978) 48 Comp Cas 368.

89 *Master Silk Mills P Ltd* v *D. H. Mehta*, (1980) 50 Comp Cas 365 Guj.

90 *See* further, *V. S. Ratnam* v *Ossar Estates Ltd*, [1989] 3 Comp LJ 355, 359 CLB, where a transfer was rejected on the ground that the transferee was the nominee of another person who was an undesirable person, and the same was held to be not proper.

Strict Construction of Restrictions

"In construing the relevant provisions in the articles it is to be borne in mind that one of the normal rights of a shareholder is the right to deal freely with his property and to transfer it to whomsoever he pleases, and this right is not to be cut down by uncertain language or doubtful implications."[1] "Any limitation on the right of transfer must be strictly complied with."[2] Moreover, "the directors must exercise their right to decline registration only by passing a resolution to that effect; mere failure, due to a deadlock or something, to pass a resolution is not a formal active exercise of the right to decline, and therefore the applicant will be entitled to be registered as a member of the company".[3] Thus, for example, in *Moodie* v *W & J Shepherd Ltd*:[4]

> The directors failed to agree to an application for transfer; one in favour of granting it and the other refused to do so. It was held that the transfer had not been declined and, therefore, the applicant must be registered.

Further, "the power must be exercised within a reasonable time; four months is not a reasonable time".[5] "The period of two months specified in Section 78 of the (English) Companies Act[6] may safely be taken as the outside limit after which there is unnecessary delay. By reason of such delay the power ceases to be capable of being exercised."[7] Similarly, where the directors have the power to veto a transfer they will lose it if it is not exercised within a reasonable time after a transfer application is lodged.[8]

Under the articles of a private company no transfer was possible without the previous sanction of the Board of directors. It was held that this would require a written resolution for sanctioning a proposed transfer.[9]

Scope of interference where power unfettered.—Where, however, the directors have an unfettered discretion, it is difficult for the National Company Law Tribunal to interfere.[10] The Tribunal has to presume, unless the contrary is

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1 Lord GREENE MR in *Smith & Fawcett Ltd, Re*, (1942) Ch 304, 306: (1942) 1 All ER 542.

2 PENNYCUICK J in *Swaldale Cleaners, Re*, (1968) 1 WLR 1710: [1968] 3 All ER 619 CA.

3 *Moodie* v *W & J Shepherd Ltd*, [1949] 2 All ER 1044.

4 *Ibid. See* also *Ramesh Chandra* v *Jogini Mohan*, 47 Cal 901 and *Mohinuddin* case, AIR 1928 Mad 571; *Babulal Choukhani* v *Western India Theatres*, AIR 1957 Cal 709: (1958) 28 Comp Cas 565.

5 S. 71(3).

6 S. 111(2) of the Indian Companies Act prescribes the same period.

7 Following, *Joint Stock Discount Co, Re*, (1886) 3 Eq 77. The Madras High Court in *M. G. Amirthalingam* v *Gudiyatham Textiles P Ltd*, (1972) 42 Comp Cas 350, upheld a rejection notified after two and a half months.

8 *Swaldale Cleaners, Re*, [1968] 1 WLR 1710: [1968] 3 All ER 619 CA.

9 *John Tinson & Co (P) Ltd* v *Surjeet Malhan*, (1997) 9 SCC 651: (1997) 88 Comp Cas 750: AIR 1997 SC 1411. A transfer without any such approval was held to be void.

10 In the case of a public company, listed or otherwise, an absolute power of refusal does not give the directors an unfettered discretion to refuse. The power would have to be exercised in good faith in the interest of the company. *Mathrubhumi Ltd* v *Vardhman Publishers Ltd*, (1992) 73 Comp Cas 80 Ker. A company listed at a recognised stock exchange was fully authorised to reject a transfer which falls in the four point formula of S. 22-A of the Securities (Contracts Regulation) Act, 1956, *Bajaj Tempo Ltd* v *Bajaj Auto Ltd*, (1994) 80 Comp Cas 618 CLB. But now this section has been *omitted*. The only surviving power of rejection is to be found in the provisions of S. 111-A. There cannot be a contrary provision in the articles.

shown, good faith on the part of the directors. The directors have to disclose their reasons. The first decision on the adequacy of such reasons has to be that of the National Company Law Tribunal under Section 111. If subsequently the matter is taken to the court (now Company Law Appellate Tribunal), it can also pronounce upon the adequacy of the reasons. Earlier to the amendment of 1988, disclosure of reasons was not compulsory. The rejected transferee had to make an application to the Central Government under Section 111 as it then stood and the Government had the power to demand a disclosure of the reasons at the pain of adverse presumption. This course proved useful to the transferee in *Bajaj Auto Ltd* v *Firodia*.[11]

> The shareholders of a company were divided into two groups. Both bought shares in the open market at exaggerated prices. The purchases effected by the controlling group were registered. Some instalments of the opposite block were also registered, but the rest were suddenly refused. The directors had the unfettered discretion to do so.

Rejected transferees applied to the Central Government under Section 111. The Government demanded reasons. The directors disclosed that they were prompted by the report of the opposite group to the Central Government that the appointment of managing agents was renewed without proper formalities; that if all the purchases were registered it would reduce the majority of the controlling block to less than three-fourth and thus jeopardise the functioning of the company. But both the Government, and on appeal, the Supreme Court, regarded these reasons as absolutely irrelevant to the consideration of the company's best interests. The report was not only in the interest of the company but also in public interest. Any reduction in the strength of the majority cannot by itself mean that the company's business would be paralysed.

Thus, it appears that the function of approving or rejecting a transfer is no longer a private affair. However widely drafted the power of rejection may be, its exercise would now have to be justified on objective reasons.[12] This has been re-emphasised by the Supreme Court in *LIC* v *Escorts Ltd*[13] because "discretion implies just and proper consideration of the proposal in the facts and circumstances of the case". The directors refused to register a bulk purchase of shares by a group of foreign companies all operated by a non-resident Indian under a family trust. The directors contended that if the purchases ostensibly effected in the name of 13 companies were regarded as a one-man affair, the ceilings prescribed by the rules under the Foreign Exchange Regulation Act, 1973 [now FEMA] would be violated and further the purchases were effected without the permission of the Reserve Bank. The permission was, however, retrospectively granted. The court advised the directors that they had no right to sit in judgment over the decision of the Reserve Bank or of the Central Government as to retrospective permissions. The FERA did not insist upon prior

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11 (1970) 2 SCC 550: (1971) 41 Comp Cas 1: AIR 1971 SC 321. *See* also *Turner Morrison & Co* v *Shalimar Tar Products*, (1980) 50 Comp Cas 296 Cal, transfer passed in haste.

12 *See* the judgment of RAY J (later CJ) at 7-11 where he traces the effect of previous authorities, *ibid*.

13 (1986) 1 SCC 264 at 326: [1986] 1 Comp LJ 91 SC: (1986) 59 Comp Cas 548.

permission. The court would not lift the corporate veil in this case to see whether all the companies were under the control of one man.[14]

Directors were not allowed to reject a duly executed transfer only on the ground that there was a family dispute between the transferor and his son,[15] or on the ground that the share certificate submitted along with the instrument of transfer was of greater number of shares than those transferred.[16]

Transfers contravening pre-emptive clauses

A company can reject a transfer contravening the provisions of the company's articles,[17] but the company can waive its right and accept a contravening transfer and once it does so, it loses the right to question the validity of the transfer. Hence, a transfer contravening articles is not a nullity,[18] nor void ab-initio.[19] A transfer in violation of pre-emptive provision can be set right by subsequent assent of shareholders or by ratification or even by acquiescence.[20] Further, as between transferor and transferee, the latter does become an equitable owner of the shares and this despite the fact that no specific enforcement can be had against the company because of the contravention of pre-emptive or other provisions.[21] The purchaser is not totally without remedies. The seller is accountable to him for all accretions to the shares, such as bonus and dividend.[22] What has been described as "the most explicit authority" is *Tett* v *Phoenix Property and Investment Co Ltd*[23] where VINELOTT J "held that despite the disregard of the preemptive provisions there had occurred a complete and effective transfer between transferor and transferee in terms of which the equitable title passed to the latter."[24] In this case, the shares in question were

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14 See further *Bajaj Tempo Ltd* v *Unit Trust of India*, (1992) 73 Comp Cas 451 CLB, where the directors' decision to refuse was based on the apprehension that the transferee company would, by reason of its inter-connections, become a monopolistic undertaking and the same was not upheld by the Board.

15 *M. M. Anandram* v *Mysore Lachia Setty & Sons P Ltd*, (1985) 58 Comp Cas 162 Kant.

16 *Kumar Exporters P Ltd* v *Naini Oxygen Acetylene and Gas Ltd*, (1985) 85 Comp Cas 97All. A transferee was not allowed to question the validity of an article empowering directors to decline a transfer of fully paid shares replacing the old article which permitted refusal of only partly paid shares. *Joseph Michael* v *Travancore Rubber and Tea Co Ltd*, (1986) 59 Comp Cas 898 Ker.

17 See *Satyanarayana Rathi* v *Annamalaiar Textiles (P) Ltd*, (1999) 95 Comp Cas 386 CLB, a transfer in violation of pre-emptive clauses.

18 *See* the old case of *Shortridge* v *Bosanquet*, (1852) 16 Beav 97; 51 ER 708.

19 See *Hunter* v *Hunter*, 1936 AC 222 HL, 264; *Coupe* v *J. M. Coupe Publishing Ltd*, [1981] 1 NZLR 275 CA and *Tett* v *Phoenix Property and Investment Co Ltd*, 1984 BCLC 599.

20 See *Hunter* v *Hunter*, 1936 AC 222 HL, 264; *Coupe* v *J. M. Coupe Publishing Ltd*, [1981] 1 NZLR 275 CA and *Tett* v *Phoenix Property and Investment Co Ltd*, 1984 BCLC 599. A member cannot be denied his proportion under pre-emptive rights out of the shares offered by another member even if there has been some irregularity in observing the company's articles which is rectifiable, *Lakshmi Natrajan* v *Bharatan Publications Ltd*, (1997) 25 Corpt LA 96 CLB.

21 *Pool* v *Middleton*, (1861) 29 Beav 646; 54 ER 778; *Heron International Ltd* v *Grade*, 1983 BCLC 244.

22 *Coachcraft Ltd* v *S.V.P. Fruit Co Ltd*, (1978) 3 ACLR 658.

23 1984 BCLC 599.

24 As summarised by A Borrowdale, *The Effect of Breach of Share Transfer Restrictions*, 1988 JBL 307, 30 11. *Hawks C. McArthur*, [1951] 1 All ER 22 and *Chinn* v *Collins*, 1981 AC 533

sold to an outsider and a transfer deed executed in his favour completely forgetting the pre-emptive clauses. Some shareholders were interested in acquiring the shares but not at a price which *Tett* was prepared to pay. Even so the Court of Appeal held that the company was not compellable to accept the transfer. The decision has been appreciated. "The privacy of a 'close corporation' is more important than the price offered by an outsider. A different decision would have defeated the intention of the incorporators when they formed the company."[25] In *Hunter* v *Hunter*,[26] shares were mortgaged to a bank. This transaction was viewed as a valid one inspite of the pre-emptive provisions. But the bank having gone to the extent of getting its nominee registered as a holder of those shares, an order was granted for rectification of the register of members by restoring the name of the original shareholder-mortgagor. The bank then transferred the shares to an existing shareholder of the company thus complying with the requirements of the company's articles that the shares could be transferred to existing members only. The original mortgagor's action questioning the validity of the transfer failed.

The articles of a private company prohibited transfer to non-members. The shares of a member were sold under a court auction. It was held that even such a sale could not knock off the prohibition. The Board of directors were entitled not to accept the transfer.[27]

Private agreement between members

A private agreement between two or more shareholders, which is not incorporated in the company's articles, restricting the right of transfer, does not bind the company. The company can be compelled to register a transfer even if it violates such an agreement.[28]

Listed public companies and pre-emptive clauses

Refusal by a listed public company to register a transfer of shares on the ground of pre-emptive rights of existing shareholders was held to be not justified. Where shares of such companies are subject to pre-emptive clauses, they have to carry a warning on the face of the certificate. There being no such

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HL, both recognising the validity of transfer of beneficial interest without formalities and also *D. J. Lal* v *S. Ganguli*, (1990) 68 Comp Cas 576 Delhi.

25 *See* the editorial note in 1986 JBL 8-9. To the same effect is *Shanta Genevieve Pommeret* v *Sakal Papers P Ltd*, (1990) 69 Comp Cas 65 Bom.

26 1936 AC 222 HL. In *Tett* v *Phoenix, etc.*, cited above, shares were sold and transfer deed executed to an outsider forgetting the pre-emptive clauses, yet the transfer was held to be not devoid of all intent and purpose. The principle of the *Hunter* case was followed in *Cruickshank Co Ltd* v *Stridewell Leather (P) Ltd*, (1995) 17 Corpt LA 415 CLB: (1996) 86 Comp Cas 439, where transfer of shares to outsiders was registered by the company and CLB ordered rectification of the register of members by retransferring to the original member.

27 *S. A. Padmanabha Rao* v *Union Theatres P Ltd*, (2002) 108 Comp Cas 108 Kant. The court followed *Manilal Baiyalal* v *Gordhan Spg & Mfg Co*, (1916) 18 Bom LR 982 and *Balwant Transport Co Ltd* v *Deshpande*, AIR 1956 Nag 20.

28 *Volvo Lastvagnar Komponenter A. B.* v *Morgard Shammar India Ltd*, (2000) 100 Comp Cas 131; *Mafatlal Industries Ltd* v *Gujarat Gas Co Ltd*, [1998] 4 Comp LJ 112: (1999) 97 Comp Cas 301 Guj.

warning in the present case, the company had no right to refuse either under Section 111 or Section 111-A.[29]

Power to refuse registration and appeal against refusal [S. 111]

This section has become confined to private companies only.

A company refusing to register a transfer on any grounds whatsoever is required by Section 111(1) to send within two months a notice of the refusal to both the transferor and the transferee or the person claiming transmission.[30] The company must disclose reasons for such refusal.[31] The transferor[32] or the transferee can prefer an appeal to the National Company Law Tribunal[33] against the refusal. The appeal must be lodged within two months of either the notice of refusal or where the company has not given any such notice, within 4 months from the date on which the papers were lodged with the company, as the case may be.[34] An opportunity must be afforded to the transferee, transferor and the company to make their representations. If the refusal, on a consideration of the whole case, does not seem to be justified, the Tribunal will issue an order to the company to register the transfer, which must be done within 10 days of the receipt of the order.[35] The nature and scope of the power of the Central Government, which was inherited by the Company Law Board, and which has now been vested in the Tribunal was explained by the Supreme Court in *Harinagar Sugar Mills* v *Shyam Sunder Jhunjhunwala*.[36]

> A company having refused to register a transfer, an appeal was preferred before the Central Government. The latter ordered the company to register the transfer but gave no reasons. The company appealed against the Government's order.

It was held that the power of the Central Government (now Tribunal) was of a judicial nature and must be exercised subject to the limitations of a judicial tribunal. "The Central Government has to decide whether in exercising their

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29 *Pawan Gupta* v *Hicks Thermometers Ltd*, (1999) 98 Comp Cas 814 CLB.

30 An appeal cannot be filed by a person who is neither a transferor nor a transferee. An appeal by an inter-mediator in the transaction of sale of shares between the transferor and transferee was not allowed. *Vinod K. Patel* v *Industrial Finance Corpn of India Ltd*, [1999] 3 Comp LJ 215. *Vinod K. Patel* v *Industrial Finance Corpn of India Ltd*, (2001) 103 Comp Cas 557 Delhi, a stranger cannot file an appeal.

31 S. 111(2). The CLB has no power to condone delay by a company in accepting or rejecting a transfer of shares. *Carbon Corpn Ltd* v *Abhudaya Properties (P) Ltd*, (1992) 73 Comp Cas 572 CLB.

32 The "person aggrieved" would include the transferor *S. V. Nagrajan* v *Lakshmi Vilas Bank Ltd*, (1997) 90 Comp Cas 392 CLB. In this case the transferor had lodged the transfer documents.

33 *Substituted* for the CLB by the Second Amendment of 2002.

34 An informal refusal is sufficient to invoke S. 111. Thus where the directors observed in their resolution that the application forms were defective and one member of the board personally informed the transmittee, that was held to be an informal refusal for purposes of S. 111, *Narinder Kumar Sehgal* v *Leader Valves Ltd*, (1993) 77 Comp Cas 393 CLB. Where a company sent the notice of refusal after prolonged correspondence and long delay, it was held that the period of two months started running from the date of the receipt of the letter. *Pushpa Vadhera* v *Thomas Cook (India) Ltd*, (1996) 87 Comp Cas 921 CLB.

35 S. 111(5).

36 AIR 1961 SC 1669. (1961) 31 Comp Cas 387. *See* the judgment of SHAH J (afterwards CJ).

power the directors are acting oppressively, capriciously, or corruptly, on in some way *mala fide*. The decision has manifestly to stand those objective tests, and has not merely to be founded on the subjective satisfaction of the authority deciding the questions."[37] Hence the Tribunal has to decide the appeal on the basis of the reasons for refusal as they have been submitted by the company. This was not done in the present case and, therefore, the matter was referred back.[38] The power of directors to refuse to accept a transfer is exercisable whether the transfer is by one member to another or from a member to an outsider.[39]

Time for Exercising Power of Refusal [S. 111(1)]

The period prescribed by the section for refusing an application for transfer is that of two months. This raises the question whether on the expiry of the two months the company loses the right of rejection and the transferee gets a vested right to get himself registered. The section does not speak anything on the point and, if it speaks at all, it only talks of penalty for the default.[40] The Bombay High Court, facing this problem, as it seems to be, for the first time, did not agree with the view either that the company would lose the right of rejection or that the transferee would acquire vested right.[41] The view reflects truism to this extent that in such a case a court order would be necessary and the court would in any case go by merits. But the position as established through cases is that the disposal must be within reasonable time and that the two months' time allowed by the Act is quite reasonable.[42] The transferee has silently to sit through this waiting period because he cannot resort to any proceedings till then.[43] Even if

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37 *See* the judgment of SHAH J at AIR 1971 SC 1669, 1674-75. Reaffirmed by the Supreme Court in *Bajaj Auto Ltd* v *Firodia*, (1970) 2 SCC 550: AIR 1971 SC 321: (1971) 41 Comp Cas 1; *LIC* v *Escorts Ltd*, (1986) 1 SCC 264 at 326: (1986) 59 Comp Cas 548. Where reasons were not given, the company should be given an opportunity to state its reasons, if any, *Talayar Tea Co Ltd* v *UOI*, 1992 Supp (3) SCC 38.

38 The Supreme Court advised public financial institutions to keep in mind while considering disinvestment of shares in bulk and transferring them to private hands that such a policy would be against public interest and not congenial to promotion of business. Care should also be taken to see that transferees are proper persons. *N. Parthsarathy* v *Controller of Capital of Issues*, (1991) 3 SCC 153: AIR 1991 SC 1420. An order of the Company Law Board is appealable and, therefore, a writ petition does not lie against the order, *Alaknanda Mfg & Finance Co P Ltd* v *CLB*, (1995) 83 Comp Cas 514 Bom.

39 *Kwality Textiles* v *Arunchalam Chettiar*, (1991) 1 SCR 140 Malaysia. Though the Company Law Board does not have the power under the section to prevent the company from parting with its estate, the CLB can prescribe its approval for alienation of property where the transferees' shares would become worthless if the property was gone, *A. J. Coelho* v *S. I. Tea & Coffee Estates Ltd*, (1997) 25 Corpt LA 89 CLB.

40 Sub-s. (12) which punishes default "in complying with any of the provisions of this section".

41 *S. P. Mehta* v *Calico Dyeing and Printing Mills Ltd*, (1990) 67 Comp Cas 533 Bom. Affirmed by the Supreme Court in *Shailesh Prabhudas Mehta* v *Calico Dyeing & Printing Mills Ltd*, (1994) 3 SCC 339: (1994) 80 Comp Cas 64 SC.

42 *Sewaldale Cleaners Ltd, Re*, [1968] 1 WLR 1710: [1968] 3 All ER 619 CA. Following this case in *Popley* v *Planarriye Ltd*, (1997) 1 BCLC 8 Ch D, it was held that it would be enough compliance with the requirement of time if the directors decide the matter within time though they failed to communicate the party of their decision. They may incur personal liability for their failure to the party or the company but there would be no violation of the requirement of time.

43 *Zinotty Properties Ltd, Re*, [1984] 1 WLR 1249: [1984] 3 All ER 754.

the transferee does not get any vested right, his position becomes stronger because the belated exercise of the power may not carry much conviction. The penalty incurred by the expiry of two months cannot be wiped out by subsequently attending to the application. The intention of the legislature seems to be to confer only a time-bound right of rejection. It is a characteristic of such privileges that they lapse with the expiry of time. The legislature means to say that the transfer shall be registered if not rejected within two months.[44]

Rectification of register [S. 111(4)]

If a person's name appears in the register of members, he is presumed to be the shareholder or member, even if, in fact, he is not so. Contrarily, if a person's name is absent from the register, apparently he is not a member, although he may have done everything to entitle him to become one. Injustice may, therefore, result if a company's register of members is not maintained according to law. It is, therefore, the duty of the company to keep the register up to date so as to give at all times the accurate and correct position as to particulars of shareholding. If the company does not do so, an order can be sought from the National Company Law Tribunal in respect of all matters falling within Sections 111 and 111-A.[45] The power to order rectification of the register has, therefore, been conferred on the Tribunal. An aggrieved person or any member or the company itself can apply for rectification on any of the following grounds:

1. Where a person's name has been entered in the register without sufficient cause. Thus rectification has been ordered on this ground where a person was induced to become a member by misleading prospectus, where allotment was invalid[46], or where a forged transfer has been registered.[47]
2. Where a person's name being in the register has been without sufficient cause deleted.[48]

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44 *Hackney Pavilion Ltd. Re*, [1924] 1 Ch 276: 1923 All ER Rep 524. The Karnataka High Court in *Kamlabai* v *Vithal Pd Co P Ltd*, (1993) 77 Comp Cas 231 Kar. came to the conclusion that a company which did not reject an application for transmission within two months was no longer in a position to do so.

45 *Volvo Lastvagnar Komponenter A. B.* v *Morgard Shanmar India Ltd*, (2000) 100 Comp Cas 131 CLB.

46 *Indian States Bank Ltd* v *Kunwar Sardar Singh*, AIR 1934 All 855: 154 IC 33; *Bank of Peshawar Ltd* v *Madho Ram*, AIR 1919 Lah 351: 51 IC 812.

47 *Societe Generale de Paris* v *Janet Walker*, (1885) 11 AC 20: 54 LT 389; *People's Insurance Co* v *Wood & Co*, AIR 1960 Punj 388. Where shares were registered in the name of a minor through signatures by the minor's mother as a natural guardian, an application by the minor's father to have the name removed was not allowed. This would require a civil adjudication as to who could act for the minor. *Jonas Hemant Bhatta* v *Surgi Plant Ltd*, (1993) 78 Comp Cas 296 CLB. *Nupur Mitra* v *Basubani P Ltd*, (2002) 108 Cri LJ 359 (CLB), the CLB can permit rectification of the register of members for the purpose of reduction of capital.

48 *Navinchandra* v *Gordhandas*, [1967] 1 Comp LJ 82: (1967) 37 Comp Cas 747, a minor's name struck off, rectification ordered. *Jayantilal* v *Gordhandas Desai Ltd*, (1968) 38 Comp Cas 405: [1967] 1 Comp LJ 272 Bom. An appeal to Company Law Board was not stayed where the dispute as to the agreement of transfer was to be adjudicated by international arbitration and the Indian company whose register was sought to be rectified was not a party to the agreement. *Insotex (India) Ltd* v *AEGNGEF Ltd*, (1995) 83 Comp Cas 358 CLB. Affirmed on appeal in *AEG-Atkiengesllscrapt* v *Insotex (India) Ltd*, (1995) 83 Comp Cas 677: AIR

3. Where a person has fulfilled every requirement of law to enable him to become a member, but the company has defaulted or delayed or caused "unnecessary delay" in placing his name in the register[49] [including refusal to register a transfer within the meaning of sub-section (1)] and where a person has rightly ceased to be a member but his name has not been removed with due promptitude from the register.[50]

This is obviously a summary remedy obtained by petition to the Tribunal.[51] Earlier to 1988 when this power was vested in the court under the now repealed Section 155, the view taken was that a regular suit for rectification could also be filed and this used to be the only appropriate remedy where complicated questions were involved.[52] Although great discretionary powers had been given to the court to "decide all questions which it was necessary or expedient to decide in connection with an application for rectification",[53] yet a petition under this section was not viewed with favour in some cases. For example, in *Jayshree Shantaram* v *Rajkamal Kalamandir P Ltd*,[54] the Bombay High Court held that:

1996 Kant 69, the court further found that many other matters were there before CLB and the balance of convenience was also against stay. The CLB has to record a finding as to how the matter before it is covered by one clause or the other and the power became exercisable. *T. G. Veera Prasad* v *Shree Rayalaseema Alkalies & Allied Chemicals*, (1999) 98 Comp Cas 806 AP. *S. Siv Kumar* v *Cirtacs Data Systems Ltd*, (2002) 112 Comp Cas 162 CLB, name deleted under allegedly forged transfer documents, criminal court conducting inquiry into the forgery aspects, the CLB, being not proper forum for such inquiry, waiting for the result of the criminal case. *Gopalkrishna Sen Gupta* v *Hindustan Construction Co*, (2002) 112 Comp Cas 166 CLB, the CLB not competent for investigating whether signatures on transfer deeds forged.

49 *H. G. Ariff* v *Surattee Bara Bazar Co*, (1919) 49 IC 288. *See also* the case of *The Indian Specie Bank Ltd, Re*, (1915) 17 Bom LR 342; AIR 1915 Bom 1, where a member had transferred all his shares and applications for registration of the transfer were duly lodged with the company. But the company went into liquidation before the transfer could be registered in the usual course of things. It was held that the transferor was not entitled to rectification of the register of members as he had not shown any unnecessary delay on the part of the company. But see *Babulal* v *New Standard Coal Co*, [1967] 1 Comp LJ 161, where a rectification was ordered in favour of a bona fide purchaser of shares who had fulfilled the requirements of transfer. There is no question of delay where the petitioner has not established his title to the shares. *K. S. Narayana Iyer* v *Talayar Tea Co Ltd*, (1995) 16 Corpt LA 258 Mad.

50 *Dale & Carrington Investments P Ltd* v *P. K. Prathapan*, (2002) 111 Comp Cas 410 CLB, permission to hold shares in a Indian Company could be granted *ex post facto*, rectification not to be ordered prematurely for deleting names of foreign investors. Confirmed in appeal to High Court in *P. K. Prathapan* v *Dale & Carrington Investments P Ltd*, (2002) 111 Comp Cas 425 Ker; *Rajiv Das (Dr)* v *United Press Ltd*, (2002) 111 Comp Cas 584 CLB, joint shareholding, company has no power to split it. This can be done only through a suit for partition.

51 Relief could be obtained under the section from any civil court. *Joginder Singh* v *Basawa Singh*, (1985) 58 Comp Cas 843 P&H.

52 *See*, for example, *Balwant Singh* v *Krishna Bus Service*, [1967] 1 Comp LJ 137; *Ramesh Chandra* v *Wearwell Cycle Co*, [1966] 1 Comp LJ 248, where all the earlier authorities have been reviewed. Where a matter was pending under S. 155, it was held that no other action would lie elsewhere in respect of the same cause of action, *India Fruits Ltd* v *Mantrad (P) Ltd* (1993) 2 Andh LT 726.

53 S. 155(3) (Now repealed).

54 AIR 196[illegible] Bom 136; (1960) 30 Comp Cas 141. For some other cases where petitions for rectification of register of members were dismissed, see *People's Insurance Co* v *Wood & Co*, AIR 19[illegible]0 Punj 388; *Laxminarayan* v *Praga Tools Corpn*, AIR 1953 Hyd 126; *Jagan Nath* v *Gopi [illegible]hand*, AIR 1915 Lah 100; 29 IC 770; *Daddy S. Mazda* v *K. R. Irani*, (1977) 47 Comp Cas [illegible]9 Cal.

Where discovery and inspection are necessary and complicated questions such as forgery and fabricated documents arise, the summary procedure trial under Section 155 (now Section 111) should not be allowed.[55]

Similarly, Delhi High Court[56] rejected a petition under the section as it involved ascertainment of a number of facts like the value of imported machinery against which shares were allotted and which required expert opinion and its cross-examination and the Madhya Pradesh High Court did not entertain a petition which required investigation as to whether there was a free consent or one under undue influence or fraud.[57] The Court of Appeal expressed the

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55 Similar opinions were expressed in *Sadashiva* v *Gandhi Sewa Samaj*, AIR 1958 Bom 247: (1958) 28 Comp Cas 137; *Manilal Gangaram* v *W. I. Theatres Ltd*, AIR 1963 Bom 40, where SHAH J explained the objects of the provisions of the Act. See [1963] 1 Comp LJ 150, 280; *Mahadeo Lal* v *New Darjeeling Union Tea Co*, AIR 1952 Cal 58; *Dhelakhat Tea Co, Re*, AIR 1957 Cal 476: (1958) 28 Comp Cas 62; *Dewan Singh Hira Singh* v *Minerva Films Ltd*, AIR 1959 Punj 106; *Benarsi Das* v *DD Cement Ltd*, AIR 1959 Punj 232; where a petition was rejected as it involved controversies under several heads; *People's Insurance Co* v *Wood & Co*, AIR 1960 Punj 388. The remedy is not available as of right without the court having discretion to refuse it, *see* at 390; *Mahendra Kumar Jain* v *Federal Chemical Works*, [1965] 1 Comp LJ 151, where the Allahabad High Court pointed out that the petitioner's title to shares being defective petition under the section was not proper, see also *Somasundram* v *Official Liquidator*, [1967] 1 Comp LJ 257, where a delayed petition for rectification was not allowed. *Public Passenger Service Ltd* v *Khadar*, AIR 1966 SC 489: (1966) 36 Comp Cas 1: [1965] 1 Comp LJ 1, Bachawat J at 492 P&H; *Puran Devi* v *Gurnam Singh*, (1977) 47 Comp Cas 796, where signature was denied. Where a person challenged the validity of the register long after his name was deleted and that too in circumstances involving voluminous evidence, discretionary remedy of the section was not allowed. *S. Gurucharan Singh Mahant* v *Ratan Sports P Ltd*, (1986) 59 Comp Cas 279. Rectification was ordered where a transfer was registered violating the requirement of the articles that shares must be offered first to existing members. *Amrit Kaur Puri* v *Kapurthala Flour, Oil and General Mills Co (P) Ltd*, (1984) 56 Comp Cas 194 P&H. A dispute about genuinness of signature of the transferor, should be relegated to a civil court, *Indian Bank* v *Deepak Fertilizers & Petrochemical Corpn Ltd*, (1999) 35 CLA 389 Bom; *Tarsen Kansil* v *Dey Spinners Ltd*, (2000) 37 CLA 132. The company disputed the validity of the documents which were produced for showing that the removal of the petitioner's name was wrongful, held, matter fit for civil suit, *Bipin K Jain* v *Savik Vijay Engg P Ltd*, (1998) 91 Comp Cas 835; 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, matter fit for civil court trial, *A. Akhilandam* v *Great Eastern Shipping Co Ltd*, [2000] 1 Comp LJ 110. *Nupur Mitra* v *Basubani P Ltd*, (2002) 108 Comp Cas 359 (CLB), there is no rule of law that in all cases the parties should be called upon to refer complicated questions of fact to a civil suit. *Bharat K. Gajjar* v *Castrol India Ltd*, (2003) 115 Comp Cas 396 CLB, proceedings under the section are in the nature of summary proceedings, serious disputes relating to title cannot be tried in a summary jurisdiction, civil suit is the proper remedy. *Tarsen Kansil* v *Dey Spinners Ltd*, (2001) 103 Comp Cas 835, allegations of fraud, forgery, manipulation, collusion, and misrepresentation, etc, can not be decided in summary jurisdiction.

56 *Punjab Distilling Industries* v *B.P.C. Mills Ltd*, (1973) 40 Comp Cas 189 Delhi.

57 *Kamla Devi Mantri* v *Grasim Industries Ltd*, (1990) 69 Comp Cas 188 MP: [1989] 3 Comp LJ 278. A dispute between joint purchasers of shares. A Full Bench of the Kerala High Court ordered the company to register the respective names in the agreed proportion. The Supreme Court rejected appeal against it. It was a matter of civil court jurisdiction and not of the company court. *K. P. Antony* v *Thandiyode Plantations P Ltd*, (1996) 86 Comp Cas 684 Ker (FB). Doubts about the validity of a will cannot be considered under this jurisdiction. *T. G. Veera Prasad* v *Shree Rayalseema Alkalies & Allied Chemicals Ltd*, (1997) 89 Comp Cas 13 CLB; *G. N. Bayra Reddy* v *Arathi Cine Enterprises P Ltd*, (1997) 89 Comp Cas 745 CLB. This jurisdiction would include an inquiry into the validity of an allotment of securities, *Shiv Dayal Agarwal* v *Sidhartha Polyester P Ltd*, (1996) 88 Comp Cas 705 CLB.

opinion that the court can deal with, even in this summary nature proceedings of the power of rectification, the matters relating to the petitioner's ownership of shares.[58] Where the question was whether the petitioner was the real transferee and questions of fraud, etc., were not at all involved, the court said that it was not necessary to drive the parties to a civil suit. There should be no hesitation in exercising the jurisdiction where matters are not too complicated and can be sorted out on the basis of evidence produced by the parties.[59] There is no general rule that whenever complicated questions of fact are involved the parties must be relegated to a civil suit.[60] The matter is to be decided by the Company Law Board (now Tribunal).[61]

But apart from the case where complicated questions arise, the Supreme Court has laid down that "the jurisdiction created by the section is very beneficial and should be liberally exercised".[62] The question whether an allotment of shares is in accordance with the articles of the company has been held by the Patna High Court to be not such a complicated question as cannot be disposed of in a petition for rectification. The court accordingly ordered deletion of names of certain persons to whom shares were allotted in violation of articles.[63] The Gujarat High Court expressed the opinion that a petition under the section is more or less analogous to a suit and, therefore, the court (now Tribunal) can decide all questions which can be tackled in a regular suit.[64]

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58 *Keene* v *Martin*, [2000] 1 BCLC 194 CA.

59 *V. L. Pahade* v *Vinay L. Deshpande*, (1999) 97 Comp Cas 889 AP. Disputes involving ownership, fraud, forgery can be relegated to a civil suit, *National Insurance Co Ltd* v *Glaxo India Ltd*, (1999) 98 Comp Cas 378 Bom.

60 *Nupur Mitra* v *Basubani P Ltd*, (2002) 108 Comp Cas 359 CLB.

61 *Khurshid Alam* v *P. Pagnon Co P Ltd*, (2002) Comp Cas 523 CLB.

62 *Indian Chemical Products Ltd* v *State of Orissa*, AIR 1967 SC 253: [1966] 2 Comp LJ 63: (1966) 36 Comp Cas 592. The Court was required by the now repealed S. 156 to order the company to send a copy of the order of rectification to the Registrar within 30 days. *Bhupinder Rai* v *S. M. Kannappa Automobiles P Ltd*, (1995) Corpt LA 262 Mad: (1996) 86 Comp Cas 18, further issue of capital and its allotment to a block of shareholders to the exclusion of others is not a matter under S. 111 of the Act. The CLB would not provide the relief of rectification where it would involve reduction of capital because the CLB does not have the jurisdiction in the matter of reduction of capital.

63 *Basudeb Kataruka* v *Dhanbad Automobiles P Ltd*, (1977) 47 Comp Cas 68 Pat. No such order could be made in a case where the company never prepared its register of members or filed any return of allotment. *Rajnikant Shah* v *Deccan Farms & Distilleries*, (1978) 48 Comp Cas 322 Bom. Rectification was allowed where allotment of securities was in violation of the company's memorandum of association. *M. V. Sathyanarayana* v *Global Drugs P Ltd*, (1999) 95 Comp Cas 595 CLB.

64 *Shri Gulabrai Kalidas Naik* v *Shri Laxmidas Lallubhai Patel*, (1978) 48 Comp Cas 438 Guj. The irregularity, if any, can be challenged within three years from the date of its entry in the register, Article 137 of the Limitation Act, 1963. *Anil Gupta* v *DCM Ltd*, (1983) 54 Comp Cas 301 Delhi. Any member can challenge an irregularity. *Killick Nixon Ltd* v *Dhanraj Mills P Ltd*, (1983) 54 Comp Cas 432 Bom. The same case decided that a company can make changes in the register of members even when it is closed to the public. The reason why every member can question the validity of the register is also explained in *Om Prakash Berlia* v *UTI*, (1983) 54 Comp Cas 469 Bom. Questions of title can now be decided, but earlier the position was different. See *Kamla Devi Mantri* v *Grasim Industries Ltd*, (1990) 69 Comp Cas 138 MP: [1989] 3 Comp LJ 278, question of the validity of a will, not decided under the erstwhile S. 155; *Kalyani Sundaram* v *Shardlow India Ltd*, (1990) 67 Comp Cas 306 Mad, a dispute about a right of pre-emption not taken up; *Kumeran Polty* v *Venad Pharmaceuticals & Chemicals*,

Where the claimant was not able to produce even a transfer form, the court allowed him to prove his title to the shares, because if he could do so, the execution of the transfer form could be ordered.[65]

The words "unnecessary delay" have not been defined in the Act and, therefore, it becomes a question of evidence to be decided on the facts of each case. A failure to register a transfer within one month of the application, which was contrary to the listing agreement, was held to be an unreasonable delay.[66]

Every shareholder has an interest in the proper maintenance of the company's register of members. Any member can make an application without showing any injury or prejudice to him. Personal grievance is not necessary for *locus standi*.[67]

On receiving such appeal against refusal or an application for rectification, the Tribunal has to hear the parties.[68] It may either dismiss the appeal or reject the application, or may order that the company shall register the transfer or transmission and the company has to comply with the order within 10 days or direct rectification of the register and require the company to compensate the aggrieved person for any loss sustained by him.[69] The Tribunal has been

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(1989) 65 Comp Cas 246 Ker, agreement to convert a loan into capital, not proved; *Vishnu Dayal Jhunjhanwala* v *UOI*, (1989) 66 Comp Cas 684 All. Where the question of the title of a person has to be decided, and if such person is not a party, he must be brought on record, otherwise no order can be passed about his title, *Subhash Chandra* v *Vardhman Spinning & General Mills Ltd*, (1995) 83 Comp Cas 641 CLB.

65 *K..P. Antony* v *Thandiyode Plantations P Ltd*, (1987) 62 Comp Cas 553 Ker. The same view has been adopted in *Harnamsingh* v *Bhagwan Singh*, (1992) 74 Comp Cas 726 Delhi, questions of title; *E. V. Swaminathan* v *K. M. M. A. Industries & Roadways P Ltd*, (1993) 76 Comp Cas 1 Mad, the beneficial nature of the jurisdiction would be lost if it were reduced to a summary jurisdiction; *Ammonia Supplies Corpn P Ltd* v *Modern Plastic Containers P Ltd*, (1994) 79 Comp Cas 163: AIR 1994 Delhi 155 NOC, the matter can be relegated to a civil suit only in cases of extreme factual complexity. *Abhipara Capital Ltd* v *J.C.T. Electronics Ltd*, (2002) 111 Comp Cas 863 CLB, company refused to accept a transfer on the ground that the signature of the transferor did not tally. The transferee proved that his letter to the transferor came back unserved. Original share certificates were with the transferee. The transferor did not lodge any objection nor asked for duplicates. No other claimant. The company directed to register the transfer.

66 *Joseph Michael* v *Travancore Rubber & Tea Co*, (1989) 66 Comp Cas 136: [1989] 2 Comp LJ 81 Ker.

67 *Om Prakash Berlia* v *Unit Trust of India*, (1983) 54 Comp Cas 469 Bom, reversed on other grounds in *Unit Trust of India* v *Om Prakash Berlia*, (1983) 54 Comp Cas 469 Bom; *Arjan Singh* v *Panipat Woolen & General Mills Co Ltd*, (1963) 33 Comp Cas 534 Punj; *Tracstar Investments Ltd* v *Gordan Woodroffe Ltd*, (1996) 87 Comp Cas 941 CLB, affirmed in *Shoe Specialities Ltd* v *Tracstar Investments Ltd*, (1997) 88 Comp Cas 471 Mad.

68 Where a pledgee of shares was registered as member and on an order of rectification his name was removed, it was not necessary that he should have been heard on the matter. *Malleswara Finance and Investment Co* v *CLB*, (1994) 81 Comp Cas 66: AIR 1994 Mad 341. Pendency of a petition for prevention of oppression and mismanagement is not a ground for refusing an application for rectification. The applicant's name was substituted on the register without any sufficient cause and he was seeking rectification, *Anand Hemant Patel* v *Ornate Club P Ltd*, (2000) 99 Comp Cas 318.

69 S. 111(5). An application for rectification filed by directors who participated in the decision to accept the impinged transfer was not allowed. There was a long delay also. *Mohanram Sastri* v *Swadharma*, (1995) 83 Comp Cas 272 Mad: *S. Seetha* v *Satyam Computer Services Ltd*, (2002) 112 Comp Cas 139 CLB, instead of accepting a duly lodged transfer, the company by negligence issued duplicates to the transferor. The company directed to register the transfer and

empowered to make necessary interim orders, orders as to costs and incidental and consequential orders regarding payment of dividends or allotment of bonus or rights shares.[70] The Tribunal has the power of deciding the applicant's title to the shares in question and of deciding generally any question which it is necessary to decide in connection with the application for rectification.[71] These provisions are applicable to the rectification of the register of debenture-holders also.[72] An appeal against refusal or an application for rectification has to be in the form of a petition in writing and accompanied by such fee as may be prescribed.[73]

Limitation Act not applicable

This sub-section does not prescribe any period of limitation.[74] Petitions under this sub-section would not be crippled by the periods prescribed by sub-sections (2) and (3). For the purposes of jurisdiction for rectification, sub-section (4) says in clause (*b*) that it includes refusals under sub-section (1).[75] Though the period of limitation is not applicable, an action which is initiated several years after the cause of action may not be entertained because of inordinate delay and latches.[76] An aggrieved person cannot be prevented from approaching the Tribunal by reason of delay in exercising his rights, the period of limitation

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also to give the transferee the bonus shares and dividend amount to which he became entitled in the meantime.

70 S. 111(6). Where a substantial acquisition of shares was under question, the CLB restrained the company from transferring its assets because otherwise the transferee would ultimately get control over a barren company, *Coetho (AJ)* v *South India Tea & Coffee Estates Ltd*, (1998) 93 Comp Cas 401 CLB.

71 S. 111(7). *Nupur Mitra* v *Basubani P Ltd*, (2002) 108 Comp Cas 359 CLB, CLB order of rectification having the effect of reduction of capital was held to be permissible.

72 S. 111(8). Sub-section (9) provides for penalty for default in complying with the orders of the Board.

73 S. 111(10).

74 The Company Law Board is not a court for the purposes of jurisdiction for rectification of register of members. Hence, the periods of limitation as prescribed by the Limitations Act, 1963 are not applicable. The only requirement will be that the petition must not suffer from laches or acquiescence, i.e., there should be no unreasonable delay in seeking relief. *Shiv Dayal Agarwal* v *Sidhartha Polyester P Ltd*, (1997) 88 Comp Cas 705 CLB: *ITG Veera Prasad* v *Rayalseema Alkalies*, (1997) 89 Comp Cas 13 CLB, the Company Law Board has the power to ask parties to go to a civil court for sorting out factual complications; *G. N. Byra Reddy* v *Arathi Cine Enterprises P Ltd*, (1997) 89 Comp Cas 745 CLB. An application after two months of refusal was held to be maintainable, *Kana Sen* v *C. K. Sen & Co P Ltd*, (1998) 91 Comp Cas 26 CLB. When matters of rectification were in the jurisdiction of courts, three-year period of limitation was applicable. *Bipin Vadilal Mehta* v *Ramesh B. Desai*, (1997) 26 Corpt LA 71 Guj.

75 *City Bank NA* v *Power Grid Corpn of India*, (1995) 17 Corpt LA 25 CLB: (1995) 83 Comp Cas 454. Unauthorised transfers are liable to be struck out, e.g., one executed by the holder of a power of attorney in a surreptitious exercise of his authority. Delay in application will not be a material factor in such a case. *Farhat Sheikh* v *Escman Metalo Chemical P Ltd*, (1991) 71 Comp Cas 88 Cal. *Gurnam Singh Gujral (Cal)* v *Indian Hotels Co Ltd*, (2002) 112 Comp Cas 86 CLB, petition filed 2 years after the name of the original owner was restored to register, held barred by time. Shares in question were a stolen property, transfer deeds were also found to be forged.

76 *C. Mathew* v *Cochin Stock Exchange Ltd*, (1997) 26 Corpt LA 312 CLB.

being not applicable.[77] Delay can be condoned. In this case the delay was condoned because it was due to a *bona fide* pursuit of other remedies.[78]

Directors' power of rectification of entries

It is open to directors to rectify the register of members of their own even where there are no objections and a wrong entry has been detected. There is no need, in such a case, to apply to the Tribunal for an order of rectification. "If there is no dispute, and if the circumstances are such that the tribunal would order rectification," the Board may itself effect the necessary corrections.[79] "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 and that a shareholder has the right to avoid a 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 cases."[80] However, the directors have no power 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 compliance with the provisions of Section 108.[81]

Application to private companies

Before its amendment in 1997, S. 111 was applicable to public companies and in a very restricted manner to private companies. After the amendment, the section applies only to private companies. Section 111-A has been *inserted* for public companies. The rulings cited in the following 3 paragraphs belong to the earlier period.

Where the shares etc., of a private company, which is not subsidiary of a public company, have been transmitted by a court order or by some other public authority, the remedies of this section will be available against the company.[82] In such a case, the Company Law Board has the alternative power of asking any member of the company to purchase such shares and to order rectification only if no member offers himself for that purpose. The Board may ask the member to pay the price invested by the purchaser of the shares or to pay an amount which may look like being a reasonable compensation in the circumstances.[83]

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77 *Mahendra Singh Mewar* v *Lake Palace Hotels & Motels P Ltd*, (1997) 27 Corpt LA 229 CLB; *UOI* v *R. C. Bhargava*, (1998) 30 Corpt LA 229 CLB. The time limit specified by the Companies Act would be applicable, but not that of the Limitation Act because the CLB is not a court, and the Limitation Act applies only to courts. *Anil R. Chhabria* v *Finolex Industries Ltd and Finolex Cables Ltd*, (2000) 99 Comp Cas 168. To the same effect *Nupur Mitra* v *Basubani P Ltd*, (2002) 108 Comp Cas (CLB), unexplained long delay, laches and acquiescence may bar a petition. *Jagjit Rai Maihi* v *Punjab Machinery Works P Ltd*, (2001) 103 Comp Cas 979 (P&H), allotment and transfer of 1972, petition in 1981 for rectification, too late.

78 *Khurshid Alam* v *P. Pagnon Co P Ltd*, (2002) 108 Comp Cas 523 CLB. *Calcutta Security Printers Ltd* v *Calcutta Phototype Co Ltd*, (2002) 112 Comp Cas 434 CLB, the question of limitation viewed liberally where the transfer was based on fraud and forged papers.

79 *Halsbury's Laws of England*, 176 [4th Edn, 1996, para 306, Vol 7(1)]; *Pool Firebrick & Blue Clay Co, Hartlay* case, (1875) 10 Ch App 157.

80 That was decided in *Wright* case, (1871) 7 Ch D 55 and *Ress River Silver Mining Co* v *Smith*, (1869) 4 HL 64; *Michaels* v *Harley Harley House Marleybone Ltd*, [1997] 3 All ER 446: [1997] BCLC 166 Ch D.

81 *Jayantilal P. Patel* v *Gordhandas Desai (P) Ltd*, (1968) 38 Comp Cas 405 Bom.

82 S. 111(12).

83 Defaults under the section are punishable under sub-section (12). *K. Subramania Iyer* v *New*

The section concludes with sub-section (13) by providing that nothing in the section shall prejudice the right of a private company to enforce a restriction under its articles as to a particular transfer. Thus the matter of refusal by a private company can also be agitated before the CLB, if not for anything else, at least for the purpose of determining whether the refusal was a bona fide enforcement of a restriction contained in the articles or alternatively the matter can be carried before the ordinary civil courts.

Thus the provisions of the section are applicable to private companies as well. The jurisdiction created by the section is equally applicable for rectification of the register of private companies. An allotment of shares by a private company which is liable to be set aside can be the subject-matter of an application under the section. Where the articles of a private company enable the directors to increase capital and allot it in a manner they thought fit and they arbitrarily chose some of themselves for the benediction to the exclusion of others, the Company Law Board held that such powers, even though absolute, have to be exercised in good faith in the interest of the company and its members and that, therefore, the allotment was liable to be set aside.[84]

Grounds of refusal under Securities Contracts Regulation Act, 1956

Section 22-A of the Act permitted a listed public company to refuse to register a transfer only on any of the specified four grounds:[85] This section has been *omitted*. The grounds stated below are no longer applicable. The rulings also belong to the earlier period.

*(A) **Bad delivery of transfer documents.***—A company can refuse to accept a transfer where the instrument of transfer is not properly prepared, not duly stamped, or signed, the certificate of shares under transfer has not been delivered or some other applicable formal or legal requirement has not been complied with.

*(B) **Contravention of law.***—The transfer in question is in contravention of some law, e.g., that the requirements of permission under the Foreign Exchange Regulation Act, 1974 have not been complied with.[86]

*(C) **Prejudicial to company or public interest.***—Where the transfer is of a nature that it is likely to change the composition of the board of directors in such a way as would be prejudicial to the interest of the company or public interest.[87]

Look Rubber P Ltd, [1989] 3 Comp LJ 242 CLB, an order for implementation of court order for transfer of shares.

84 *Jitendra Nath Saha* v *Shyamal Mondal*, [1993] 1 Comp LJ 76: (1995) 82 Comp Cas 688, also reported as *Cetus Electronics P Ltd*, (1995) 82 Comp Cas 688 CLB. The Board added that it can go into facts and order rectification where the directors did not observe the principles of equity and fair play.

85 *Surat Electricity Co Ltd* v *UOI*, AIR 1995 Bom 377: (1995) 4 Bom CR 71 Bom, the purport of SCRA is to regulate buying and selling of securities, prevention of undesirable speculation and to ensure free transferability of securities.

86 *Bharat Petroleum Corpn Ltd* v *Stock Holding Corpn of India Ltd*, (1995) 82 Comp Cas 539 CLB, refusal by a company to register shares in the name of a company on behalf of mutual funds held justified being violative of S. 49, Companies Act.

87 *Nakhanda Mfg & Finance Co (P) Ltd* v *CLB*, (1995) 83 Comp Cas 514 Bom, this is a statutory guideline to the directors to consider, firstly, whether the transfer would cause change in the composition of the company's board and, if so, whether that change would be adverse to the company or public interest. If the Company Law Board upholds the directors' refusal, an appeal lies but not a writ petition. The provisions of the section were held to be constitutionally valid. The reasons on which directors refused were found to be justified because it appeared that the transferees intended to change things in a prejudicial manner. The court found that purchases were effected with institutional funds which was something against public interest and the small shareholders totalling to 46% would have suffered most from change in the complexion of management. 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%

(*D*) ***Stay order.***—Where the transfer has been stayed by a court order or by any other authority or tribunal.[88]

Where the refusal is on the basis of the last three grounds, namely, contravention of law, likelihood of prejudicial changes or stay order, the company had to state its reasons and refer the matter to the CLB and inform the parties accordingly. The decision of CLB, unless appealed against, prevailed. For example, if the rejection was on the ground of likelihood of a prejudicial change, the board of directors had to state their reasons for so thinking and the CLB then decided whether the reasoning of the company was sound or not.[89]

Appeals

An appeal used to lie to the High Court against an order of the Company Law Board (now Tribunal) on a question of law but not on a question of fact.[90] Now appeals would lie from the decision of the National Company Law Tribunal to the Company Law Appellate Tribunal.

By virtue of the consequential amendment of the Companies Act introduced by the Depositories Act, 1996, the provisions of Section 111 are to be confined in their application only to private companies. For companies whose shares are traded at a stock exchange, a new provision, namely, Section 111-A has been introduced. The section says that shares, debentures and any interest in such company shall be freely transferable. Where the securities are transferred through a depository, an appeal will lie to the National Company Law Tribunal in connection with any transfer only if it is in contravention of the provisions of the Securities and Exchange Board of India Act, 1992 or any regulations made thereunder or the Sick Industrial Companies (Special Provisions) Act, 1985 (SICA)[91] or any other law for the time being in-force.

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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 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 shareholders blocks and the other two were holding 70%. *Vimal K. Gupta* v *Auto Lamps Ltd*, (1996) 86 Comp Cas 157: [1995] 3 Comp LJ 152. 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 *UOI*, AIR 1995 Bom 377: (1995) 4 Bom CR 71 Bom; *Texmaco Ltd, Re*, [1996] 1 Comp LJ 154.

88 A pending litigation is not sufficient to prevent the company from accepting a transfer. There should be a stay order. *Vikas Jalan* v *Hyderabad Industries Ltd*, (1997) 88 Comp Cas 551 CLB.

89 See *Gammon India Ltd* v *Hongkong Bank (Agency) (P) Ltd*, (1992) 74 Comp Cas 123: [1992] 1 Comp LJ 279 CLB; *Patel Engg Co Ltd* v *Patel Relators P Ltd*, (1992) 74 Comp Cas 395 CLB; *Gordon Woodroffe Ltd* v *Trident Investment*, (1994) 79 Comp Cas 764 CLB: [1994] 1 Comp LJ 313.

90 The distinct trend of authorities at present is to restrict the scope of refusal to accept a transfer of shares and this trend has been confirmed by the amendment of 1988 by making it compulsory that reasons for refusal must be indicated. *Joseph Michael* v *Travancore Rubber & Tea Co*, (1989) 66 Comp Cas 491: [1989] 2 Comp LJ 81 Ker. A listed public company can refuse only on the grounds specified in S. 22-A of the Securities (Contracts Regulation) Act, 1956 which are: (1) defective instrument of transfer; (2) transfer contravening any law; (3) the transfer is likely to result in a change in the board of directors which would prejudice the company's or public interest, and (4) the transfer in question is prohibited by a court order. The jurisdiction of the Company Law Board under the Securities Act is independent of S. 111 of the Companies Act. *Sinclair Hotels and Transportations Ltd* v *Pressman Advisory Services Ltd*, [1989] 2 Comp LJ 49 CLB.

91 Provisions of this Act have been merged into the Companies Act.

An application under the section can be filed by a depository, by the company itself, or by a participant or an investor. The Tribunal has been given the discretionary power to make an interim order suspending voting rights in respect of the shares under transfer till the completion of inquiry and making of final orders. The transferee can exercise voting rights unless they are suspended by an order of the Tribunal. Pending the disposal of the application, any further transfer of the shares in question shall entitle the transferee to exercise voting rights. The provisions of sub-sections (5), (7), (9) and (12) of Section 111 are applicable to proceedings under Section 111-A.

The Tribunal should not mechanically reject a petition because of some pendency of the same matter before a civil court. The matter should be disposed of on due consideration of affidavits so as to find out whether there is a real possibility of conflicting decisions.[92]

Public Companies: Amendment of Section 111 by Depositories Act [Insertion of S. 111-A]

Section 111 has been amended by the Depositories Act, 1996. Sub-s (14) was added by the amendment. The affect of the amendment is that Section 111 has been confined in its operation to private companies only.

By way of further amendment Section 111-A was inserted by the Depositories Related Laws (Amendment) Act, 1997. This section applies to public companies only. It became necessary because Section 111 having been confined to private companies only, no system of rectification remained available in cases of public companies. The section lays down that subject only to the provisions in the section, the shares or debentures of a listed company shall be freely transferable. Thus, the transfer of securities has been made the subject-matter of a free market independent of the director's discretionary power of refusal. For example, where the refusal to accept a transfer was on ground that the shares were a part of the trust which was of perpetual nature, it was held that the shares being those of a public limited company, they were freely transferable and the company was not concerned with the conditions of the trust.[93] A company was not allowed to refuse a transfer on the ground that the transferees were not the natives of the company's State of registration.[94] A

92 *Nupur Mitra* v *Basubani P Ltd*, (1999) 35 CLA 97 Cal.

93 *Jose Pulikken* v *Damien Subsidies & Kuries Ltd*, [2000] 4 Comp LJ 421 CLB: (2000) 109 Comp Cas 699. See also *Kamdhenu Chemicals P Ltd* v *Advent Computer Services P Ltd*, [2000] 4 Comp LJ 424 CLB, another case of unjustified refusal.

94 *Namita Gupta* v *Cachar Native Joint Stock Co Ltd*, (1999) 98 Comp Cas 655 (CLB). The ground of refusal that the transfer was prejudicial to the interest of the company is no longer applicable. Section 22-A of the Securities Contracts (Regulation) Act, 1956 was scrapped in 1995 by the Depositories Act. *Canara Land Investment Ltd* v *Sea Rock Investment Ltd*, (1999) 35 CLA 209. *Industrial Development Bank of India* v *Rambal Ltd*, (2003) 114 Comp Cas 167 Mad, bank credit facilities given to a company subject to the condition that promoters would not alienate their shares. The company agreed to disinvestment of its shares to the extent of 26% in favour of a foreign company. This being contrary to the loan agreement, the bank was granted an injunction to restrain it.

company was not allowed to refuse a transfer on the ground that the transferee was an ex employee who was dismissed for irregularities and his admission as a shareholder would not be in the interest of the company.[1]

The Tribunal cannot look into validity of an allotment of shares by a public company. The powers which it could have exercised under Section 111(4) cannot now be exercised in respect of public companies under Section 111-A.[2] The Tribunal is no longer in a position to look into title disputes relating to transfers to which the company is not a party. A public listed company is bound to accept a transfer for which all the appropriate papers have been filed. The Tribunal cannot go into questions as to whether there had been an actual sale or not or whether documents were genuine or forged. All such matters have now to be the subject-matter of a civil suit.[3]

If a company refuses to register a transfer within two months of lodgement and the transferee brings the matter before the Tribunal, it shall direct the company to register the transfer. Thus, the right of appeal to the Tribunal against the refusal is allowed only to the transferee. The Tribunal has also been given the power to order rectification of the register of members by the company or by the depository where a transfer is in contravention of the Securities and Exchange Board of India Act, 1992 or any rules or regulations made by SEBI[4] or Sick Industrial Companies (Special Provisions) Act, 1985[5] or any other law for the time being in force. It means that the Tribunal's power of ordering rectification is in respect of violation of laws.[6] Unlawful transfers are open to

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1 *P. R. Gokhale* v *T.N. Mercantile Bank Ltd*, (2002) 110 Comp Cas 866 CLB.

2 *Gopal Krishna Banga* v *Poona Industrial Hotels (P) Ltd*, (1999) 34 CLA 177 Bom.

3 *Charanjit Singh Ghumman* v *Dr Reddy's Laboratories Ltd*, (1999) 97 Comp Cas 360 CLB.

4 See *SPS International Ltd* v *Vijay Remedies Ltd*, (1998) 93 Comp Cas 547 (CLB), where the scope of CLB power was explained and the transfers were found to be in violation of SEBI Guidelines in respect of the promoters' lock-in-period; *Bakhtawar Construction Co (P) Ltd* v *Blossom Industries Ltd*, (2000) 36 CLA 14 CLB, violation of SEBI Takeover Code. Another similar ruling, *Azzilfi Finlease & Investments (P) Ltd*, [2000] 1 Comp LJ 118 CLB. *Shirish Finance & Investment P Ltd* v *M. Sreenivasulu Reddy*, (2002) 109 Comp Cas 913 (Bom), acquisition of shares in violation of SEBI Regulations as to limit was held to be void, rectification not allowed.

5 This Act has been repealed and its provisions merged into the Companies Act.

6 *SPS International Ltd* v *Vijay Remedies Ltd*, (1998) 30 Corpt LA 113 CLB, the power has become so confined. It does not extend to inquiry into fraud, forgery, lack of authority, procedure etc; *Volvo Lastvagnar Komponenter* v *Morgardshammar India Ltd*, (1998) 30 Corpt LA 382 CLB, in example of wider jurisdiction earlier. *McDowell & Co Ltd* v *Shaw Wallace & Co Ltd*, (2002) 108 Comp Cas 306 CLB, the word law does not include case-law. transfer in favour of a business rival was not allowed to be refused. *Pratibha Dilip Karnad* v *Satyam Computer Services Ltd*, (2002) 108 Comp Cas 347 CLB, refusal because of a court decree, no interference. The CLB (now Tribunal) has no power to grant compensation because of delay in dematerialisation of shares. *Deccan Cements Ltd* v *Geekay Exim (India) Ltd*, (2002) 112 Comp Cas 616 CLB, shares pledged as security for repayment of loan, on default in repayment, the company was requested to register the shares in the name of the pledgee. The company's refusal was held to be not justified. *Asha Purandare* v *Integrated Controls P Ltd*, (2002) 112 Comp Cas 623 CLB, a typographical error in mentioning the number of one of the certificates was held to be not a ground for rejecting the transfer of the whole lot. *Maruti Udyog Ltd* v *Pentamedia Graphics Ltd*, (2002) 111 Comp Cas 56 CLB, rejection of application for transfer of pledged shares not proper even if the pledgor had given notice to the company not to register the transfer. *Shapoorji Pallonji Finance Ltd* v *Mideast India Ltd*,

rectification. An application for this purpose can be made by a depository, company, participant or investor. This is a *post-registration power*. The proviso to sub-section (2) confers the power to order registration, a *pre-registration power*, of a transfer which has been refused by the company without sufficient cause. The three grounds mentioned in the proviso would constitute a sufficient cause.[7] Two months period is available for this purpose. In the case of a depository, two months run from the date of transfer; in other cases, from the date of delivery of the transfer papers. During the inquiry before the Tribunal, the transfer would remain effective giving the transferee his voting rights unless suspended by the Tribunal. As a matter of interim relief, the CLB (now Tribunal) could also suspend exercise of voting rights. This power is, of course, there in the civil court. The power of the civil court in this respect has not been taken away by these provisions. The matters of title and rights are generally raised in civil proceedings.[8] The shares will also remain further transferable with similar effects.

The procedural aspects of Section 111 would apply to the proceedings, under S. 111-A also i.e., powers of the CLB (sub-section 5); decisions as to questions of title (sub-section 7); and penalty for default in implementing orders of CLB (sub-section 12) [now Tribunal].

The decision of the Company Law Board (Mad) in *Shashi Prakash Khemka* v *NEPC Micon Ltd*[9] shows the extent to which the Company Law Board (now Tribunal) has suffered loss of jurisdiction. It will have no jurisdiction under Section 111 in matters of public companies. That section now gives jurisdiction to the CLB [now Tribunal] only in respect of private companies. In the matter of public companies the CLB (now Tribunal) will have jurisdiction only in respect of transfers and transmission and that too only to enforce all lawful transfers and to prevent all unlawful transfers. A dispute about shareholding arising in any other manner than involving a transfer is now a matter for a civil suit and not a petition before the CLB (now Tribunal) even if the matter arose before the jurisdiction of the CLB was thus curtailed.

(2002) 110 Comp Cas 868 CLB, transfer of pledged shares could not be refused. *Mani Credit Capital P Ltd* v *Reliance Industries Ltd*, (2002) 111 Comp Cas 808 CLB, retransfer of pledged shares to the transferor, rectification ordered.

7 *Estate Investment Co (P) Ltd* v *Eiltap Chemicals Ltd*, (1999) 96 Comp Cas 217 CLB. Where a person claims that shares registered in some other person's name really belong to him, he must have court decision to that effect and then rectification of the register would automatically follow, *Eternit Everest Ltd* v *Neelamani Bhartiya*, [1999] 2 Comp LJ 171 Raj.

8 *Shirish Finance & Investment P Ltd* v *M. Sreenivasulu Reddy*, (2002) 109 Comp Cas 913 Bom; *M. Sreenivasulu Reddy* v *Kishore R. Chhabria*, (2002) 109 Comp Cas 18 Bom.

9 (1997) 90 Comp Cas 228 (CLB-Mad). The jurisdiction of the CLB earlier was wider and included decision on questions of title and all other incidental matters, *Mafatlal Industries Ltd* v *Gujarat Glass Co Ltd*, (1998) 30 Corpt LA 167 Guj. *Indian Bank* v *Kiran Exports Ltd*, (2001) 104 Comp Cas 320, shares held by a bank under a pledge were allowed, on the failure of the pledger to pay back, to be registered in the name of the bank. *Shyama Prasad Murarka* v *Calcutta Stock Exchange Assn Ltd*, (2002) 108 Comp Cas 203 (CLB), Stock Exchange Co not allowed to refuse transfer, refusal communicated 2 years after lodgment was held to be not proper, Stock Exchange had no right to call upon the transferee to deposit the consideration amount in the Stock Exchange.

Civil remedy not barred

A wrong entry affects the rights of shareholder in so many respects, e.g., the right to dividend, participation in meetings and in further issues, etc. etc. It partakes of the nature of a common law right. Therefore, the right to file a civil suit for rectification of the register has not been taken away by the Act.[10] A petition under the section for declaration of title to certain shares was not allowed. A civil suit is the only appropriate remedy for such relief.[11]

Restriction on extent of shareholding

The articles of a company provided that no member shall hold more than 10% of the company's share capital. It was also provided that a member holding more than 10% would not count for voting in excess of 10%. A member purchased shares in excess of 10%. The rejection of his application for registration was held to be not justified. The provision did not have the effect of a blanket prohibition. The court directed registration of transfer subject to the restriction on voting rights.[12]

Condonation of delay in filing appeals

Section 637-B is a general authorisation to the Central Government to condone delays in making applications to the Central Government. This provision was applicable at a time when appeals under Section 111 were to be filed before the Central Government. But now they have to be filed before the Tribunal which has been constituted into an independent and autonomous quasi-judicial body. Whether this section would still be applicable is a matter that has to wait for a decision.

It is believed that there is no power vested in the Tribunal to condone delay. Section 5 of the Limitation Act, 1963 confers power on courts to condone delay in filing applications and appeals if there is a sufficient cause. The Limitation Act is not applicable to the Tribunal, it being not a court. Where a matter requiring determination of "sufficient cause" was returned by the High Court to the CLB under the remark that the CLB did have the power to condone delay, the CLB looked at the matter again and found that time was lost by the petitioner in his efforts to persuade the directors and he approached for his remedy only after ultimate failure. He had sufficient cause to ask for condonation.[13]

Procedure of transfer [S. 108]

A transfer of shares is completed by registration with the company, or in other words, a transfer is incomplete until registered and the transferor remains legal owner of the shares liable for the unpaid amount, if any.[14] Thus

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10 *M. Srinivasulu Reddy* v *Kishore R Chhabaria*, (2002) 109 Comp Cas 18 Bom.
11 *Arun Kumar Mallick* v *Hindustan Lever Ltd*, (2002) 112 Comp Cas 464 CLB.
12 *M. Ratnavarma Padival* v *Karnataka Theatres Ltd*, (2002) 109 Comp Cas 461 Kant.
13 *V. K. Gupta* v *Auto Lamps Ltd*, (1999) 96 Comp Cas 555 (CLB).
14 See *LIC* v *Escorts Ltd*, (1986) 1 SCC 264 at 327: (1986) 59 Comp Cas 548: [1986] 1 Comp LJ 91 SC. *Martin Castelino* v *Alpha Omega Ship Management P Ltd*, (2001) 104 Comp Cas 687,

where[15], without any fault or unnecessary delay on the part of the company, duly lodged transfers could not be registered before the commencement of winding up, the transferor could not have his name removed from the list of contributories.[16] But where a transfer was omitted by mistake or oversight, rectification was ordered notwithstanding winding up.[17]

The transferee is the proper person to apply for registration of transfer, but the transferor may also apply.[18] "The transferor is entitled as much as the transferee to enforce registration."[19]

The following conditions must be fulfilled before a company can lawfully register a transfer.[20]

1. The instrument of transfer must be executed both by the transferor and the transferee. The instrument must specify the name, address and occupation, if any, of the transferee. It should also comply with the requirements of the company's articles.[21]

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a mere agreement to sell shares does not deprive a member from exercising his rights as a member.

15 *Indian Specie Bank Ltd, Re*, (1915) 17 Bom LR 342.

16 *See* also *Amraoti Electric Supply Co* v *R. S. Chandak*, AIR 1954 Nag 293.

17 *Sussex Brick Co, Re*, [1904] 1 Ch 598: [1904-07] All ER Rep 673: 90 LT 426.

18 S. 110(1).

19 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 he makes no objection to the transfer within two weeks from the receipt of the notice. Section 110(2). *See also* sub-section (3).

20 S. 108. Oral transfers are not recognised by the Act. See *Greene* v *Green*, [1949] Ch 333: [1949] 1 All ER 167. A company cannot lawfully register a transfer unless the requirements of the section are complied with. See *Jayantilal* v *Gordhandas Desai Ltd*, (1968) 38 Comp Cas 405: [1967] 1 Comp LJ 272 Bom. The same court observed in *Jagdish Mills Ltd, Re*, AIR 1955 Bom 79 "that if a company registers an instrument of transfer which is not duly stamped, it would be doing something which is not lawful". Cf *M.K. Sugar Mills* v *I.K. Sugar Mills*, AIR 1965 All 135: (1963) 33 Comp Cas 1142. Such registration can be rectified by an order of the Board. *Mahabir Singh* v *Jai Singh*, (1978) 48 Comp Cas 558 Delhi. Formalities of S. 108 are, however, not necessary where shares have been sold under an order of a court. *Hanuman Mills (P) Ltd*, (1977) 47 Comp Cas 644 and also by Delhi High Court in *CIT* v *Bharat Nidhi Ltd*, (1982) 52 Comp Cas 80 Del, the court saying that unless the requisite documents are prepared and signed the ownership would not pass because the shares would not be in a deliverable state.

21 For example, the transfer fee prescribed by the articles must be paid to the company itself. Subsequent deposit of the fee in the court will not do. *P. V. Chandran* v *Malabar and Pioneer Hosiery (P) Ltd*, (1992) 73 Comp Cas 80 Ker; *Mathrubhumi Ltd* v *Vardhman Publishers Ltd*, (1992) 73 Comp Cas 80 Ker: [1992] 1 Comp LJ 234 Ker DB. Though consideration amount has to be mentioned in the instrument, the company is not concerned with that fact. That is a matter between the transferor and transferee. Though inadequacy of consideration is no defence, where shares and transfer forms were handed over by the husband without the authority or signature of his wife to whom the shares belonged and the consideration amount was also Re 1, the transaction was held to be void. *John Tinson & Co (P) Ltd* v *Surjeet Malhan*, (1997) 9 SCC 651: (1997) 88 Comp Cas 750: AIR 1997 SC 1411. In *Karnataka Theatres Ltd* v *Venkatesan*, AIR 1996 Kant 18, the CLB did not approve the rejection of a transfer on the ground that the price paid for the shares was very high. *Mallina Bharathi Rao* v *Gowthami Solvent Oils Ltd*, (2001) 105 Comp Cas 700 (CLB), the articles of the company enabled a director to sign transfer documents as an agent of the expelled shareholder without his consent, the transfer was held to be void. The article was against the mandatory provision of S. 108 which requires that the document must be signed by the transferor or his authorised signatory.

2. The instrument of transfer should be duly stamped.[22]
3. The instrument should be delivered to the[23] company along with the certificate relating to the shares transferred.[24]
4. The instrument of transfer should be in the prescribed form and, before it is signed by the transferor, and before any entry is made in it, should be presented to the prescribed authority.[25]

The prescribed authority will stamp or otherwise endorse on the instrument the date on which it is so presented. It should then be executed by the transferor and completed in all other respects and should be presented to the company for registration. Presentment to the company should be made, in the case of shares quoted on the recognised stock exchange, before the company closes the register of members in accordance with the provisions of the Act or within twelve months, whichever is later. In other cases, presentment should be made within two months from the date of presentment to the prescribed authority.[26] An instrument of transfer which does not fulfil this requirement shall not be accepted.[27]

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22 Stamps on the transfer form must be defaced or cancelled or else the company can reject it and where a form was resubmitted after cancellation and by that time its validity period had expired, the company was held to have rightfully rejected the same. *A. S. Manvi* v *Kritapur Processing and Ginning Factory Ltd*, [1989] 3 Comp LJ 217, 220 CLB. Where the company changed its articles of association before the rectified instrument was presented again, the alteration would be effective against the transfer. *Mathrubhumi Ltd* v *Vardhman Publishers Ltd*, (1992) 73 Comp Cas 80 Ker; *Muniyamma* v *Aarthi Cine Enterprises (P) Ltd*, (1991) 72 Comp Cas 555 Kar. The Company Law Board did not accept a petition for rectification which was based on transfer form carrying uncancelled stamps. *Bharat Hotels Ltd, Re*, (1994) 81 Comp Cas 897 CLB. Company itself cancelling stamps, registration of the transfer was held to be invalid, *Subhash Chandra* v *Vardhman Spg & Gen Mills Ltd*, (1995) 83 Comp Cas 641 CLB.

23 These requirements are prescribed by S. 108, a proviso to which provides that where the instrument of transfer has been lost, the company may register the transfer on such terms of indemnity as the board of directors may think fit. S. 108 (1) proviso.

24 If no such certificate is in existence, the letter of allotment should be sent. S. 108(1). See *Amraoti Electric Supply Co* v *R. S. Chandak*, AIR 1954 Nag 293. A company cannot be compelled to register a share purchaser's name unless the certificate for the relevant shares alongwith the instrument of transfer are made available to the company. *Pravin Agarwal* v *Reckitt & Coleman of India Ltd*, (2000) 37 CLA 119 CLB.

25 Who is a person already in the service of the Government. S. 108(1-A) (*a*).

26 The Central Government has the power to extend time in hard cases. This power has been delegated to Regional Directors. The power is exercisable on the basis of hardship to the applicant and beyond this neither any hearing nor any natural justice are requisite. *Vishnu Dayal Jhunjhanwala* v *UOI*, (1989) 66 Comp Cas 684, 693 All.

27 *See* Sections 108(1-A) and (1-B) as substituted by the Amendment Act of 1966. *See also* sub-sections (1-C) and (1-D) which contain exceptions. Where shares are vested in the State by operation of law, neither these formalities, nor rectification of the register are necessary. *Doypack Systems (P) Ltd* v *UOI*, (1988) 2 SCC 299, decided under Swadeshi Cotton Mills Co (Acquisition and Transfer of Undertakings) Act, 1986. An instrument of transfer which has been rejected by the company by reason of the efflux of time cannot be presented again under any such thing as a symbolic revalidation by the Registrar of Companies. *Mathew Michael* v *Teekoy Rubber and Tea Co*, (1994) 79 Comp Cas 370: [1993] 3 Comp LJ 449 CLB. *Chandravadan Parikh* v *Krishna Mingranite Ltd*, (2003) 115 Comp Cas 423 (CLB), the transferor had signed the papers before his death as a security for a loan, the company was compelled to register the transfer.

Blank Transfers

This last mentioned requirement is intended to do away with the evil of blank transfers. A blank transfer form means a form which has been signed by the transferor only and there is no other entry on it. It is given over to the transferee with the right to have himself or any other person registered as a shareholder. Before the provision was enacted, a blank form could remain in circulation for any length of time creating many problems mostly that of evasion of taxes and priority between transferees. But now it can remain in circulation only for twelve months after it is signed by the authority or upto the time when the company closes its register of members.[28]

But, apart from this restriction, a blank transfer form is a valid instrument. The basic principles were restated by the Gujarat High Court in *Pranlal Jayanand Thakar* v *V. R. Shelat*[29]. Firstly, an instrument of transfer which carries no entry except the signature of the transferor is a valid instrument. Secondly, a person to whom such an instrument is delivered along with share scrips gets an implied authority to complete the instrument. Thirdly, the transferee acquires good title to the shares if he has received the documents in good faith and for consideration.[30]

The facts of the case were that the transferee had received the shares under a gift deed from a lady who signed blank transfer forms which, however, could not be registered before her death.

The other heirs having claimed the shares, the court held that the transferee had not acquired a good title to shares as he had received them without consideration. The gift was not complete without registration. But on appeal to the Supreme Court this decision was reversed.[31] In the view of the Supreme Court a complete gift had taken place on delivery of the share scrips and transfer

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28 As amended in 1988 and enforced with effect from 15-6-1988, GSR 559(E) of 10-6-1988.

29 (1973) 43 Comp Cas 203 Guj.

30 The following cases establish these principles: *Official Assignee, Bombay* v *Madholal Sindhu*, (1946) 48 Bom LR 828: AIR 1947 Bom 217; *Maneckji Pestonji Bharucha* v *Wadilal Sarabhai & Co*, (1926) 28 Bom 771: AIR 1926 PC 38: 53 IA 92; *Arjun Prasad* v *Central Bank of India*, AIR 1956 Pat 32, where the transferee got himself registered and that was held to be valid. A blank transfer does not operate in anybody's favour unless the formalities of transfer have been complied with. *Travancore Electro-Chemical Industries Ltd* v *Alagappa Textiles*, (1972) 42 Comp Cas 569 Ker. A blank transfer which is delivered as a pledge and not as transfer does not have this effect. Violation of marketing regulations such as the Securities Contracts (Regulation) Act, 1956 renders the transfer to be ineffective. The transferor remains the owner for purposes of attachment. The above Act applies to shares of non-listed companies as well if they are marketable. *A. K. Menon* v *Fairgrowth Financial Services Ltd*, (1994) 81 Comp Cas 508 (Special Court); *BOI Finance Ltd* v *Custodian*, (1994) 81 Comp Cas 508 (Special Court). The word "law" as used in that Act means the law in force in India and not merely the Companies Act. A transfer form not complying with stamp law is not valid. *Kothari Industrial Corpn Ltd* v *Lazor Detergents (P) Ltd*, [1994] 1 Comp LJ 669 Mad. Where there was no such violation of laws, a pledge of shares-cum-contract to sell, was held to pass property upon delivery of certificate and blank transfer form, *Jagdishchandra Champaklal Parekh* v *Deccan Papers Mills Co Ltd*, (1994) 80 Comp Cas 159 CLB.

31 *Vasudev Ramachandra Shelat* v *Pranlal Jayanand Thakur*, (1974) 2 SCC 323: AIR 1974 SC 1728: (1975) 1 SCR 534: (1975) 45 Comp Cas 43.

deeds. Registration with the company was a formality which had nothing to do with the completeness of the gift as between the parties.[32]

Transfer contravening Section 108

When requirements of Section 108 are complied with, the company registers the transfer. The name of the transferor is struck off the register of members and that of the transferee substituted. It has been held by the Calcutta High Court that the requirements of Section 108 are directory and not mandatory.[33] The court followed a decision of the Allahabad High Court[34] where it was pointed out that Section 108 does not impose any penalty for, nor indicates any consequences of, its non-observance. It is also not exhaustive of all the modes of transfer. It covers only two. It has no application to other modes of transfer. Hence a company can register a transfer without the original scrips being produced. All that it can require to protect itself is an indemnity against untoward consequences. The court accordingly ordered the company to register a transfer when the transferee was not able to produce the original scrips. But the decision of the Allahabad High Court which the Calcutta High Court purported to follow had been reversed by the Supreme Court in *Mannalal Khetan* v *Kedar Nath Khetan*.[35] RAY CJ laid emphasis upon the words "shall not register" as used in Section 108, which leave no doubt that the provision is mandatory. "The mandatory character is strengthened by the negative form of the language. The prohibition against transfer without complying with the provisions of the Act is emphasised by the negative language. Negative language is worded to emphasise the insistence on compliance with the provisions of the Act." The facts were that on the partition of a family shares were agreed to be transferred in blocks between members and the company registered the transfers on the basis of the partition deed itself without any transfer form having been executed. The Supreme Court accordingly ordered that this transfer should not have been registered.[36]

Once the necessary formalities have been complied with, the transferee gets the right to be put on the register. Emphasising this fact in *LIC* v *Escorts Ltd*[37], CHINNAPPA REDDY J of the Supreme Court observed:

> Where the transfer is regulated by a statute, as in the case of a transfer to a non-resident which is regulated by the Foreign Exchange Regulation

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32 Re-emphasised by the Supreme Court in *LIC* v *Escorts Ltd*, (1986) 1 SCC 264 at 323-324: (1986) 59 Comp Cas 548: [1986] 1 Comp LJ 91 SC.

33 *Jatia Cotton Mills Ltd* v *Ram Prasad Bajoria*, (1975) 45 Comp Cas 686 Cal.

34 *Maheshwari Khetan Sugar Mills* v *Ishwari Khetan Sugar Mills*, (1963) 33 Comp Cas 1142 All.

35 (1977) 2 SCC 424: (1977) 47 Comp Cas 185.

36 *See* further *Shanta Genevieve Pommeret* v *Sakal Papers (P) Ltd*, (1990) 69 Comp Cas 65 Bom, where of the four transferors, the signature of one on the transfer from was not there and the from was held to be ineffective as a transfer. *Kothari Industrial Corpn* v *Lazor Detergents (P) Ltd*, [1994] 1 Comp LJ 178 CLB Mad, in the case of a transfer which has already been registered, deficiency in stamps, if any, must be pointed out within one year because otherwise the transferee would be deprived of his opportunity of getting things rectified.

37 (1986) 1 SCC 264 at 327: (1986) 59 Comp Cas 548: [1986] 1 Comp LJ 91 SC.

Act, the permission prescribed by the statute must be obtained. In the absence of the permission, the transfer will not clothe the transferee with the right 'to get on the register'. Where the permission has been obtained, the transferee may ask the company to register the transfer and the company may not refuse except for a bona fide reason, [but] neither arbitrarily nor for any collateral purpose. The paramount consideration is the interest of the company and the general interest of [its] shareholders. Once the permission is obtained it is not open to the company.... to take upon itself.... the task of deciding whether the permission was rightly granted.[38]

Demat transfers

The provisions of this section as to procedure and formalities of transfer are not to apply where both the transferor and transferee are entered as beneficial owners in the records of a depository.[39]

Unfair Trade Practices in Securities Market

For prevention of unfair trade practices in the securities market, the Securities and Exchange Board of India (SEBI) has prescribed SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to the Securities Market) Regulations, 1995. The rules provide for an investigation in respect of the conduct and affairs of any person buying, selling or otherwise dealing in any securities. Persons connected with the securities market would include primary sellers or buyers. Such persons can be proceeded against even if the transaction in question has been carried through a broker or agent. Securities market is not confined to stock exchanges only. SEBI has the power to call for information and documents relevant to an inquiry even from persons against whom an inquiry cannot be or has not been constituted.[40]

Certification of transfer [S. 112]

Ordinarily, the transferor hands over the certificate of shares to the transferee who then lodges it with the company for registration. But where the shares transferred are less than the number of shares included in one certificate,

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38 Citing *Fry, Re*, [1946] 2 All ER 106, where the permission of the Treasury was requisite and that being not obtained the company was not compelled to register the transfer. A transfer not approved at a meeting of the board is not effective and is liable to be struck down. *Tarlok Chand Khanna* v *Raj Kumar Kapoor*, (1983) 54 Comp Cas 12 Delhi. As between transferor and transferee, a transfer becomes complete when the contract is documented and tax authorities are bound to recognise it whether it has been accepted by the company or not. See *CIT* v *M. Ramaswamy*, (1985) 57 Comp Cas 7 Mad. Transfer of the right to receive dividends on shares is not the same thing as transfer of the shares themselves. Shares are not ordinary goods. They are a part of a complex web of relations. The whole of the principles relating to ordinary goods cannot apply to them. *Khadija* v *P. K. Mohd (P) Ltd*, (1985) 58 Comp Cas 543. The right to have the transfer registered arises when it is complete in all respects. *K. N. Narayanan* v *ITO*, (1984) 55 Comp Cas 182 Ker. Where the company did not accept a lodged transfer and continued to deal with the transferor, it was injuncted from preventing the transferor from exercising the normal rights of a shareholder, *Chougle Matrix Hebs Ltd* v *Chowgule & Co Hind (P) Ltd*, [2000] CLC 1830 AP.

39 Consequential amendment made by the Depositories Act, 1996.

40 *Karnavati Fincap Ltd* v *SEBI*, (1996) 87 Comp Cas 186 Guj.

or where they are transferred to different persons, the transferor has to lodge the share certificate with the company. The company then gives him a certificate saying that the shares under transfer have been lodged with the company. This is called "certification of transfer". In effect it is a representation to any person acting on the faith of the certification that the company has received such documents as go to show a *prima facie* title of the transferor, but not that the transferor has any title to the shares.[41] Thus in *Bishop* v *Balkis Consolidated Co*:[42]

> *B* transferred his shares to two persons and lodged the certificate with the company. The company certificated the transfer, but, instead of destroying the original certificate, returned it to the transferor who borrowed money on it.

The company was held not liable to the lender. Even if he had deceived a person to accept the transfer of those shares the company would not have been liable to the transferee. "The reason is that the share certificate is neither a negotiable instrument nor a warranty of title on the part of the company issuing it...."[43]

But if a company issues a false certification negligently or deliberately, it would be liable to any person who is deceived by having acted on the faith of the certification.[44] A certification is deemed to be made by the company when it is signed by a person authorised to do so.[45]

Forgery in transfer

Sometimes a forged instrument of transfer may be presented for registration. "The first thing that a company should, therefore, do when a transfer is tendered, is to inquire into its validity."[46] "It has, therefore, become usual, when a transfer is brought, not to register it at once, but, as one precaution, to write to the registered address of the shareholder, and inform him that such a transfer has been lodged, and that if no objection is made before a day specified, it would be registered."[47] But, notwithstanding this precaution, a forged transfer may chance to slip through[48] and the consequences will be:

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41 S. 112(1).

42 (1890) 25 QBD 512 CA.

43 Charlesworth, COMPANY LAW at 151 of 8th Edn, 1965 (Ed. by T.E. Cain): [at 260 of 11th Edn, 1977].

44 S. 112(2).

45 S. 112(3).

46 BLACKBURN J *Bahia & San Francisco Rly Co, Re*, (1868) LR 3 QB 584: 18 LT 467.

47 BLACKBURN J in *Societe Generale de Paris* v *Janet Walker*, (1885) 11 AC 20, 35: 54 LT 389. The Department of Company Affairs (DCA) has advised companies to satisfy themselves where there is doubt or apprehension about genuineness of signature. Circular No 10/93 of 13.8.93.

48 This was the course pursued in *Swan* v *North Br Australasian Co Ltd*, 7 CBNS 411, but the company's letter was intercepted by the forger. The result of the consequent litigation showed that even after all those precautions the company did suffer from registering the transfer, being obliged in the end to restore shares to *Swan*.

Firstly, a forged transfer is a nullity and, therefore, the original owner of the shares continues to be the shareholder and the company is bound to restore his name to the register of members.[49]

Secondly, if the company has issued a share certificate to the transferee and he has sold the shares to an innocent purchaser, the company is liable to compensate such a purchaser if it refuses to register him as a shareholder.[50]

Thirdly, if the company has been put to loss by reason of the forged transfer, it may recover indemnity from the person who lodged it.[51]

Relationship between transferor and transferee

A shareholder who has contracted to sell his shares becomes a constructive trustee of the transferee for those shares until the transfer is duly registered. It is, therefore, the duty of the transferor not to sell the shares again; "nor should he prevent or do anything to prevent the company from accepting the purchaser or his nominee".[52] But he is not bound to do more. And so a transferor who sold his shares on a stock exchange was held not liable when the company, having the power to do so, refused to register the transferee as a member.[53] In such a case the legal title to the shares remains in the vendor, but the beneficial interest is transferred to the purchaser. "The vendor is the trustee of all property annexed to the shares. He is a trustee not only of the *corpus* but also of the income."[54] The transferee is entitled to recover dividend amount or bonus shares that might have been received by the transferor.[55] He must pay the dividends, if any, to the purchaser.[56] The purchaser also has the right to control the exercise by the

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49 *Barton* v *N. Staffordshire Rly*, (1888) 38 Ch D 458: 58 LT 549; *Barton* v *LNW Rly*, (1889) 24 QBD 77: 62 LT 164; followed in *People's Insurance Co* v *Wood & Co*, AIR 1960 Punj 388 at 390.

50 See *Balkis Consolidated Co Ltd* v *Fredrick Tomkinson*, 1893 AC 396: 69 LT 598; *Dixon* v *Kennaway & Co*, [1900] 1 Ch 833: 82 LT 527.

51 *Sheffield Corporation* v *Barclay*, [1905] AC 392: 93 LT 83. Where the share certificate was sent to a wrong person of the same name and he transferred the shares to a bank, he faced prosecution for impersonation under S. 116, *BPL Sanyo Technologies Ltd* v *Rahul Agarwal*, (1995) 83 Comp Cas 885 Raj.

52 *London Founders Assn* v *Clarke*, (1888) 20 QBD 576: 59 LT 93. Where transfer documents are valid and the same have been registered by the company, their validity cannot be brought into question on account of any dispute between transferor and transferee, such as failure to pay purchase price in full. *K. Kamaraj* v *Mackimalai Tea Estates (P) Ltd*, (1995) 16 Corpt LA 270; *Muniyamma* v *Arathi Cine Enterprises (P) Ltd*, (1991) 72 Comp Cas 555 Kant. Where a person was present as a director in the board meeting which approved a transfer he was not allowed afterwards to question its validity. *Mukundlal Manchanda* v *Prakash Roadlines Ltd*, (1991) 72 Comp Cas 575 Kant. This decision was affirmed in *Suresh Kumar Manchanda* v *Prakash Roadlines Ltd*, (1996) 87 Comp Cas 102 Kant; *Milan Sen* v *Guardian Plasticote Ltd*, (1998) 91 Comp Cas 105 Cal.

53 *Ibid.* But where the transferor obstructs the transfer, he will have to indemnify a person who has suffered by reason of the obstruction. *Hichens, Harrison, Woolston & Co* v *Jackson & Sons*, [1943] AC 266.

54 *E. D. Sasoon & Co Ltd* v *K. A. Patch*, (1943) 45 Bom LR 46; *Wimbush, Re*, [1940] Ch 92: [1940] 1 All ER 229: 162 LT 133.

55 *Vikas Jalan* v *Hyderabad Industries Ltd*, (1997) 88 Comp Cas 551 CLB, transferee's right to dividend.

56 Now expressly recognised by the Supreme Court in *CIT* v *India Discount Ltd*, (1969) 2 SCC 514: 75 ITR 191. The beneficial interest of the transferee cannot be attached for claims against the transferor. See *D. J. Lal* v *S. Ganguli*, (1990) 68 Comp Cas 576 Del, where the court

vendor of the right to vote and he may so control it as to ask the vendor to vote for the alteration of the company's articles so as to procure transfer of shares in his name.[57]

But then how far is the transferor bound to obey the wishes of the transferee? The limits have been explained by the Supreme Court in *R Mathalone* v *Bombay Life Assurance Co.*[58]

> A shareholder disposed of a part of his holding, but the company refused to register the transferee as a shareholder. Meanwhile the company increased capital by issuing further shares to the existing shareholders. A number of shares were offered to the transferor, but he applied to take only those few which appertained to his unsold shares. The transferee sought to compel him to apply in his name for the whole of the shares and that for the benefit of the transferee.

But the argument did not find favour with MAHAJAN J of the Supreme Court. He laid down "that as long as a transfer is not registered the transferor is the trustee of the transferee for the shares — a trustee for the dividends and the right to vote. But he cannot be called upon to incur additional liability. He is not bound to obtain for the benefit of the transferee new shares in the further issue of capital. Nor is the principle of equitable trust extended to cases where the transferee has not taken active steps to get his name registered with due diligence." But his Lordship added that if the transferor of his own volition chose to obtain the new shares which appertain to the shares sold by him, he would have to hand over those shares to the transferee on payment of the amount spent.[59]

If the shares are partly paid and the company calls upon the transferor to pay the unpaid balance, the transferee must provide the money or indemnify the transferor against the amount of the call.[60]

A person who gets shares under a gift deed with blank transfer forms and is not able to get them registered until the transferor's death, acquires a good title to them, as against the legal heirs.[61] This was not applied in a situation in which blank transfer forms were handed over not by the owner herself or under her signature but by her husband without her authority.[62]

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permitted review of an order of attachment passed in ignorance of the fact that shares standing in the name of the transferor in the company's records in fact stood transferred to another.

57 *Ibid. See also* the decision of the Supreme Court in *R. Mathalone* v *Bombay Life Assurance Co*, AIR 1953 SC 385: 24 Comp Cas 1; *Hardoon* v *Belilios*, 1901 AC 118: 83 LT 573.

58 AIR 1953 SC 385: 24 Comp Cas 1.

59 Re-emphasised by the Supreme Court in *LIC* v *Escorts Ltd*, (1986) 1 SCC 264 at 323: (1986) 59 Comp Cas 548: [1986] 1 Comp LJ 91 SC. Followed in *Pradip Kumar Sarkar* v *Luxmi Tea Co Ltd*, (1990) 67 Comp Cas 491, 509 Cal. Where the transfer in question was registered by the company and the transferee received the dividend amount and subsequently the transfer was held to be invalid with the result that the shares reverted to the transferor, the transferee was held to be not bound to pay back the dividend amount received by him. *Mathew Michael* v *Teekoy Rubber & Tea Co*, (1994) 79 Comp Cas 370: [1993] 3 Comp LJ 449 CLB.

60 *Spencer* v *Ashworth, Partington & Co*, [1925] 1 KB 589: [1925] All ER Rep 324 CA.

61 *Vasudev Ramchandra Shelat* v *Pranlal Jayanand Thakur*, (1974) 2 SCC 323: AIR 1974 SC 1728: (1975) 1 SCR 534: (1975) 45 Comp Cas 43.

62 *John Tinson & Co (P) Ltd* v *Surjit Malhan*, (1997) 9 SCC 651: (1997) 88 Comp Cas 750: AIR 1997 SC 1411.

Bonus shares issued after the transfer were held to be the property of the transferee and not that of the transferor.[63] Where the transfer documents were lost in post and the transfer became delayed because the company did not receive the original documents and in the meantime bonus shares were issued, the transferee was not allowed to sue the company in respect of those shares. His remedy was to proceed against the transferor to whom they were allotted because his name was still there in the register.[64]

Compensation for Misrepresentation as to Value

Any misrepresentation by the transferor as to the value of the shares will make the transferor liable to make good the transferee's loss, if any. Where the transferor told the transferee that according to his forecast the company's earnings would touch a particular figure which turned out to be wrong, the transferor was held liable to pay damages ascertained on the basis of the difference between the warranted earnings and actual earnings.[65] A founder member signed a blank transfer form to enable the company to increase the membership base of the company by transferring some of his founder member's shares. The company used the shares for other purposes. The aggrieved member was allowed to recover compensation measured by the value of his shares.[66] Where a director is buying from a member there is a fiduciary duty to disclose the truth about the value of the shares. If this duty is not performed the seller member would be entitled to compensation for his loss. The measure of compensation would be the value of his shares at the time of sale. A valuation based on estimated future income stream would be preferable to the one based on the value of net realisable assets. But because of uncertainties in the income position, the assets value was held to be preferable in this case.[67] A clause in a sale agreement excluding liability for breach of warranty about the value of shares would be given narrowest possible meaning against the seller.[68]

Depository scheme

The procedural requirements, as noted above, show that the country's stock markets are functioning under a cumbersome process for effecting transfers of securities. A scheme for establishing depositories has been announced to record ownership details in book entry forms.[69] Investors in securities will have the option to continue with the existing system of ownership and transfer through share certificates or to come under the depository mode. Each depository would have to register itself with SEBI and to obtain from it a certificate for commencement of business. Each depository will have its agents to be known as participants. Such agency can be conferred on banks, financial institutions, or large corporate brokerage firms. A shareholder who joins a participant, his

63 *Vikas Jalan* v *Hyderabad Industries Ltd*, (1997) 88 Comp Cas 551 CLB.
64 *Pyariben M. Shah* v *NIIT Ltd*, (2002) 111 Comp Cas 816 CLB.
65 *Lion Nathan Ltd* v *CC Bottlers Ltd*, (1996) 2 BCLC 371 PC.
66 *Lloyd* v *Poply*, [2000] 1 BCLC 19 Ch D.
67 *Platt* v *Platt*, [1999] 2 BCLC 745 Ch D.
68 *Dixon Group plc* v *Murray Obodynski*, [2000] 1 BCLC 1 CA.
69 Hindustan Times, Sept 22, 1995, p 19, by means of a Presidential Ordinance.

shares will be dematerialised. His name will be entered in a book showing him as a beneficial owner. In the company's records the depository will be shown as the registered member. But all the benefits of shareholding will remain vested in the individual shareholders. A shareholder will have the right to withdraw from the scheme after joining it. His share certificate will be restored to him and his name brought back to the register of members.

Transfers are recorded automatically on delivery versus payment basis with constant flow of information to the company's depository.

Other things will remain the same. The duty of the company to accept a transfer and the right of the transferor or transferee to appeal to the National Company Law Tribunal against refusal by the company will remain the same.[70]

It is predicted that scores of foreign institutional investors (FIIs) will pump in billions of dollars into Indian Stock Exchanges. Market operations will be very convenient with the elimination of the physical movement of share certificates, etc., and minimisation of forged and other bad deliveries of transfer documents. The system will involve consequential changes in the Companies Act, Stamp Act and the Income Tax Act. The costs of transfer will be minimised because of the elimination of burdensome paper work.[71]

Priority between transferees

Where a shareholder has fraudulently sold his shares to two different transferees, the first purchaser will, on the ground of time alone, be entitled to the shares in priority to the second.[72] A person assigned his property, including some shares, for the benefit of his creditors. The assignee failed to get the share certificate, but gave notice of assignment to the company. The assignor sold the shares to another, who applied for registration. It was held that the assignee's claim was prior in time and, therefore, entitled to registration.[73] Similarly, where a person, holding shares in trust for his wife, mortgaged them, but, before the mortgage could be registered, the wife asserted her claim and was held to have priority.[74] But the claimant second in point of time may displace the original priority of the first purchaser by showing that as against him he has acquired the full status of a shareholder; or, at any rate, that all the formalities have been complied with and that nothing more than some purely ministerial act remains to be done by the company.[75] But the subsequent transferee who gets his name registered with notice of the prior transfer is not entitled to priority.[76]

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70 The National Company Law Tribunal, however, would have reduced powers. See notes under S. 111-A.

71 *See* Depositories Act, 1996.

72 *Societe Generale de Paris* v *Janet Walker*, (1885) 11 AC 20; 54 LT 389.

73 *Peat* v *Clayton*, [1906] 1 Ch 659; 94 LT 465.

74 *Ireland* v *Hart*, [1902] 1 Ch 522; 86 LT 385.

75 *Moore* v *North Western Bank*, [1891] 2 Ch 599; 64 LT 456.

76 *Coleman* v *London County & Westminster Bank*, [1916] 2 Ch 353.

Specific enforcement of agreement to sell shares

An agreement for dealing in shares is specifically enforceable. A company, having contracted to buy a controlling block of shares, applied for specific enforcement and it was held to be no defence for the other party to say that the company had not yet complied with the requirements of Section 372 to enable it to invest in shares of other companies.[77]

Mortgage or pledge of shares

A share in a company is moveable property. It can, therefore, be delivered as a security for raising a loan. Where a share certificate is delivered to the pledgee it will operate as a pledge. The pledgee can only retain possession till his dues are paid.[78] Where not merely possession of share certificates is delivered, but some right or interest is created in favour of the lender, such as, for example, handing over blank transfer forms under the signature of the transferor, it operates as a mortgage. The mortgagee gets a special interest, for he can have himself registered as a shareholder and the same will be effective against the transferor and his representatives. Where the lender gets himself registered as a shareholder, it would be a clear cut complete transfer. No residuary interest in the pledged shares would survive in favour of the borrower. His interest is protected by his right of redemption, i.e. his right to recover back the shares on paying back the lender.[79] In a case of this kind before the Patna High Court:[80]

> Certain share certificates were delivered to a bank as against a loan. The blank transfer forms in respect of those shares were signed by all the persons whose signatures were necessary and were delivered to the bank. The company subsequently went into winding up and the bank had the scrips registered in its name, which was done by the liquidator with the permission of the court.

It was held that the registration in favour of the bank was valid. DAS J stated the effect of authorities in these words:[81]

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77 *Brooke Bond India Ltd* v *UB Ltd*, (1994) 79 Comp Cas 346 Bom. Where the purchaser is a joint family, the contract would be enforceable by asking for registration in the name of the *karta* of the family. *Vickers Systems International Ltd* v *Mahesh P. Keshwani*, (1992) 73 Comp Cas 317 CLB. There is also the decision of the Company Law Board that a company can lawfully refuse to register a transfer of shares which is, in reference to the buying company, void by reason of violation of S. 372. *Gordon Woodroffe Ltd* v *Trident Investment*, (1994) 79 Comp Cas CLB: [1994] 1 Comp LJ 313. An agreement to sells hares was specifically enforced even when there was some delay in delivery caused by the fact that the seller received the share certificate from the company with some delay. *Grant* v *Cigman*, (1996) 2 BCLC 24 Ch D.

78 See *Kunhunni Elaya Nayyar* v *Krishna Pattar*, AIR 1943 Mad 74, where LEACH CJ recognised the validity of a pledge of shares by mere delivery of possession and without the need for any instrument of transfer. The only difference would be that for enforcing the security he would have to resort to a court of law.

79 *M. Ratnavarma Padival* v *Karnataka Theatres Ltd*, [2000] CLC 489: (2000) 38 CLA 171 Kant.

80 *Arjun Prasad* v *Central Bank of India*, AIR 1956 Pat 32.

81 *Id.*, at 35.

Thus where under the articles of the company a transfer of shares may be made by an instrument in writing, the shareholder may sign a blank transfer and hand it over to a purchaser or mortgagee with authority to the holder of it for the time being to fill in the name of the transferee, and such a transfer when filled in can be sent in for registration and no objection can be raised by the company to its validity.[82]

Where the original transferee of blank forms further delivers them in blank to another person, the latter will get the rights of the transferor but no better rights. The transfer being in blank, he cannot say that he had received it in good faith.

A simple delivery of share certificates unaccompanied by any transfer forms operates only as a simple mortgage, what is called in English law as an equitable mortgage.

NATURE OF SHARE

A man's movable property is of two kinds, namely, chose-in-possession and chose-in-action. Chose-in-possession means property of which one has actual physical possession, but chose-in-action means property of which one does not have immediate possession, but has a right to it, which can be enforced by a legal action. This right is generally evidenced by a document, for example, a railway receipt. A share in a company is also a chose-in-action and a share certificate is the evidence of it.[83] Section 2(46) defines "shares" as share in the share capital of the company, and includes "stock" except where a distinction between stocks and shares is express or implied.[84] But in India a share is also regarded as "goods".[85] Section 82 of the Companies Act, 1956, provides that

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82 Banks have been directed by the Reserve Bank of India to have the shares pledged to them registered in their names. A pledge under a short term loan was held not to confer that right and, therefore, refusal by the company to register the shares in the name of a bank was held to be justified. *Canara Bank* v *Ankit Granites Ltd*, (1999) 97 Comp Cas 511 (CLB). The bank has the right to get itself registered where the pledge is under a long term cash credit arrangement. The fact that no consideration was mentioned in the transfer form was immaterial because this requirement is for stamp duty and the nationalised banks are exempt from stamp duty. *Indian Bank* v *Kiran Overseas Exports Ltd*, [2000] 4 Comp LJ 416 (CLB). Where a "deed" is requisite for a transfer, mere form will not do beyond serving as an evidence of the parties' intention. *Colonial Bank* v *Frederick Whinney*, (1886) 11 AC 426. Other cases considered by the court where blank transfers were recognised as conferring right upon the transferee: *Tahiti Cotton Co, Re*, (1874) 17 Eq 273; *Colonial Bank* v *Cady*, (1890) 15 AC 267; *Fox* v *Martin*, (1895) 64 LJ Ch 473; *Colonial Bank Ltd* v *Hepworth*, (1887) 36 Ch D 36; *Harrold* v *Plenty*, (1901) 2 Ch 314; *Carter* v *Wake*, (1877) 4 Ch D 605; *London and Midland Bank* v *Mitchell*, (1899) 2 Ch 161.

83 *VGM Holdings, Re*, [1942] Ch 235, 241. Adopted by the Supreme Court in *Sri Gopal Jalan & Co* v *Calcutta Stock Exchange Assn*, AIR 1964 SC 250, 252: 33 Comp Cas 862; *Viswanathan* v *East India Distilleries & Sugar Factories*, AIR 1957 Mad 341: (1957) 27 Comp Cas 175.

84 *LIC* v *Escorts Ltd*, (1986) 1 SCC 264 at 320: (1986) 59 Comp Cas 548: [1986] 1 Comp LJ 91 SC, where the nature of a share and the position of shareholder is explained.

85 *Manekji Pestonji Bharucha* v *Wadilal Sarabhai & Co*, (1926) 1A 92; *Elaya Nayar* v *Krishna Pattar*, (1942) 2 MLJ 120: AIR 1943 Mad 74; *Arjun Prasad* v *Central Bank of India*, AIR 1956 Pat 32, in all these cases shares were considered as goods. *Indian Iron & Steel Co* v *Dalhousie Holdings Ltd*, AIR 1957 Cal 293. It has been held that shares do not mature into goods before issue. Hence an applicant for shares is not a consumer so as to create jurisdiction in a consumer forum to interfere in the matter on the ground of an alleged unfair trade practice, *Morgan Stanley Mutual Fund* v *Kartick Das*, (1994) 4 SCC 225: (1994) 81 Comp Cas 318 SC.

shares or other interest of any member in a company shall be movable property. An amendment of Section 82 introduced by the Companies (Amendment) Act, 1999 says that while before this amendment Section 82 confined itself to the "shares or other interest of any member", the statement should now be read as "shares, debentures or any other interest of any member." And Sale of Goods Act defines goods as including every kind of moveable property.[86] Hence shares in a company in India are goods and not mere chose-in-action.[87] The analysis of the "share" in terms of goods has been carried further to some of its natural implications by the Supreme Court in *LIC* v *Escorts Ltd.*[88] If shares are goods, rules relating to passing of ownership in goods would apply. Section 19 of the Sale of Goods Act says that property in the goods sold passes when it is intended to pass. "Shares" are specific goods and Section 20 of the Act says that ownership in specific goods passes when the contract is made. Thus a purchaser of shares becomes the owner of the property in the shares when he contracts to buy them. The inevitable implication of these provisions is that the company cannot deprive him of his ownership by refusing to register him as a shareholder unless there is a genuine reason to do so. But even so shares are not "goods" in the ordinary sense of the word.[89]

> Shares are a peculiar kind of movable property which cannot pass from hand to hand like bales of cotton. The property in these shares belonged to the registered shareholders and could not be transferred to another except according to the articles of the company.[90]

Thus the exact nature of a share does not admit of easy explanation, the company being an altogether distinct person from the members composing it. It is universal, though not obligatory, for an incorporated company to have a capital stock. It is equally universal to divide the capital into shares of nominal value. A person who holds such a share is known as the shareholder. Each shareholder, therefore, holds a portion of the capital of the company. "A share means a share in the capital of the company. It is a tangible property."[91] "But shareholders are not, in the eyes of law, part owners of the undertaking. The undertaking is something different from the totality of the shareholdings."[92] All the assets of the company are vested in the corporate body and not in the individuals composing it. Hence a share does not constitute the holder a part owner of the company's capital.

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86 Sale of Goods Act, 1930, S. 2.

87 It was held in *Hazarimull Sohanlal* v *Satish Chandra Ghose*, ILR 46 Cal 331, that a share certificate passing from hand to hand with blank transfer deeds does not thereby become a negotiable instrument. Accordingly, a bona fide purchaser of shares from a person, who is in possession of them by fraud, does not acquire a good title to them.

88 (1986) 1 SCC 264 at 321: (1986) 59 Comp Cas 548: [1986] 1 Comp LJ 91 SC. In an earlier decision of the Delhi High Court, *CIT* v *Bharat Nidhi Ltd*, (1982) 32 Comp Cas 80 it was recognised that unless the requisite documents were prepared and signed, the shares would be unascertained goods and not in a deliverable state.

89 *France* v *Clark*, (1884) 26 Ch D 257.

90 *Vadilal Sarabhai* v *Manekji Pestonji Bharucha*, AIR 1923 Bom at 423.

91 *SNDP Yogam, Re*, ILR 1969 Ker 516: [1970] 1 Comp LJ 85.

92 *Short* v *Treasury Commissioners*, [1948] 1 KB 116 at 122: [1947] 1 All ER 22.

But shareholders are the owners of certain rights and interests and subject to some liabilities. A shareholder acquires an interest not in a mere chattel, but in the company itself, an interest of a permanent nature. "A share is the interest of a shareholder in the company measured by a sum of money for the purpose of liability and dividends, in the first place, and of interest, in the second, and also consisting of a series of contract as contained in the articles of association."[93] "A share is not a sum of money but an interest measured by a sum of money and made up of various rights and liabilities. A share is an existing bundle of rights."[94] "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 any other. This was recognised in *Solloway* v *McLaughlin*.[95] Therefore, each share certificate with the depository evidences the same bundle of rights and each bundle of rights can satisfy the client's proprietary interest as any other."[96] A share, for example, entitles the holder to receive a proportionate part of the profits of the company; to take part in the management of the company's business in accordance with the articles, to receive a proportion of the assets in the event of winding up and all other benefits of membership.[97] A share also carries some liabilities, for example, the liability to pay the full value in winding up. All these rights and liabilities are subject to the terms and conditions contained in the company's article. Rights and liabilities as regulated by articles are of the very essence of a share. "When, therefore, the owner of the share dies, what passes upon his death and what has to be valued is nothing more than the totality of his rights and liabilities as they exist under the provisions of the Companies Act and the constitution of the particular company."[98] "The act of becoming a member [of a corporation] is something more than a contract; it is entering into a complex and abiding relation."[99]

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93 *Borland's Trustee* v *Steel Bros & Co Ltd*, [1901] 1 Ch 279, 288. Adopted by the Supreme Court in *Charanjit Lal* v *UOI*, AIR 1951 SC 41 at 55: 1950 SCR 869: (1951) 21 Comp Cas 33.

94 *Pauline, Re*, [1935] 1 KB 26 cited with approval by the Supreme Court in *CIT* v *Standard Vacuum Oil Co*, [1966] 1 Comp LJ 187 at 192: AIR 1966 SC 1393.

95 [1937] 4 All ER 328: [1938] AC 247.

96 *CA Pacific Finance Ltd Re*, [2000] 1 BCLC 494; *Harvard Securities Ltd, Re*, [1997] 2 BCLC 369 CA.

97 *See* comment on "share" in A DICTIONARY OF ENGLISH LAW. Some of the rights of shareholders have been listed in the judgment of the Supreme Court in *LIC* v *Escorts Ltd*, (1986) 1 SCC 264 at 326: (1986) 59 Comp Cas 548: [1986] 1 Comp LJ 91 SC. "The rights of a shareholder are (*i*) to elect directors and thus to participate in 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 dividends; (*iv*) to apply to the court for relief against oppression; (*v*) to apply for relief against mismanagement; (*vi*) to apply for winding up; (*vii*) to share in the surplus on winding up. Also see *Charanjit Lal Chowdhury* v *UOI*, AIR 1951 SC 41: (1951) 21 Comp Cas 33.

98 *Pauline* case, [1935] 1 KB 26, 57. The nature of a share has been fully explained in *Bacha F. Guzdar* v *CIT*, (1955) 1 SCR 876 at 881-82: AIR 1955 SC 74: (1955) 25 Comp Cas 1.

99 HOLMES J in *Modern Woodman* v *Miner*, 267 US 544, 551.

A share has become a symbol of "passive property".[1] The "active property" is under the control of the corporate managers. The legal concept of the shareholder is still that of the owner of the enterprise. But in fact his position has receded to that of the "functionless rentier" of capital.[2] Having supplied capital to the enterprise, he does not wish to be bothered except by dividends.[3] His investment confers upon him a claim on income. "What is bought and sold in the market is not productive wealth itself, but income producing prospects. Right to income has become commodity for exchange."[4] "Tersely, the shareholder has a piece of property with an open market value."[5]

RETURN AS TO ALLOTMENT [S. 75]

Within thirty days[6] of allotment of shares, a company is required to send to the Registrar a report, known as the "return as to allotment". It must contain the following particulars:

1. The number and nominal amount of shares allotted; the names, addresses and occupations of the allottees; the amount, if any, paid or payable on each share. No shares should be shown as allotted for cash unless cash has actually been received in respect of the allotment.[7]
2. Contracts in writing[8] under which shares have been allotted for any consideration other than cash, must be produced for examination of the Registrar.
3. Where bonus shares have been issued, the return must show the nominal amount of the shares allotted; names and addresses and occupations of the allottees and a copy of the resolution authorising the issue of such shares.[9]
4. Where the shares have been issued at a discount, the return must include a copy of the resolution authorising such an issue, a copy of the Tribunal's order sanctioning the issue, and, where the rate of discount is more than ten per cent, a copy of the order of the Central Government permitting the issue.[10]

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1 The concepts of "active property" which means control of the corporate wealth and of "passive property" which means the interest of the shareholder in the corporation first coined by Berle and Means in MODERN CORPORATION AND PRIVATE PROPERTY, (1932) 279.

2 *See* Mason in his introduction to THE CORPORATION IN MODERN SOCIETY, (1959) and Hatherington, *Corporate Responsibility*, (1969) Stan LR at 255.

3 *See* Livingston, THE AMERICAN STOCKHOLDER.

4 Paul P. Harbrecht, *The Modern Corporation*, (1964) 64 Columbia LR 1410 at 1415.

5 Berle and Means, 287, note 26 above.

6 The Registrar can extend this period if he is satisfied on an application by the company that it was inadequate for complying with the requirements of the section. Such application may be made before or after the expiry of the period of 30 days [S. 75 (3)].

7 Proviso to S. 75(1)(*a*) *added* by the amendment of 1965.

8 S. 75(1)(*b*). Where such a contract is not in writing, the company must submit a document containing the prescribed particulars of the contract. The document must be stamped with the same amount of stamp duty as would have been payable if the contract had been in writing. S. 75(1).

9 S. 75(1)(*c*)(*i*).

10 S. 75(1)(*c*)(*ii*). Where the period of thirty days is found to be inadequate, the company may apply to the Registrar for extension. S. 75(3). The "return" need not include the allotment of

ISSUE OF SHARES AT DISCOUNT [S. 79]

Generally speaking, the Companies Acts have always discouraged issue of shares for a price less than their face value. Allotment of shares at a discount is *ultra vires* and, therefore, the allottees who have been put on the register of members become bound to pay the full value of their shares.[11] But a contract to take shares at a discount is not enforceable.[12]

Law does not tolerate issue of shares at a discount even in an indirect way. Thus where a company issued debentures at a discount, which is allowed by the Act, and gave each debenture-holder the right to convert his debentures into shares, it was held that it was a colourable scheme for issuing shares at a discount and, therefore, was not legal.[13] But, subject to the following strict conditions[14], a company may issue its shares at a discount. In the first place, the shares of the class issued for the first time are not allowed to be sold at a discount. Discount can be allowed only on that class of shares which the company has already once issued before at full value. Secondly, the company contemplating such an issue must have become entitled to commence business at least one year before the date of issue. The procedure to be followed is this. A resolution authorising the issue must be passed. The resolution must specify the rate of discount which must not exceed ten per cent. except with the approval of the Central Government.[15] Finally, the sanction of the Central Government must be obtained and the shares issued within two months of the Board's sanction.

In the case of revival and rehabilitation of sick industrial companies, the power under the section is to be exercised by the National Company Law Tribunal instead of the Central Government.[16]

Sweat equity shares [S. 79-A]

The Companies (Amendment) Act, 1999 has introduced this section (w.e.f. 31-10-98) enabling companies to issue shares in lieu of services. The shares should be of a class which has already been once issued. The issue should be authorised by a special resolution at a general meeting of the company. The resolution should specify the number of shares and their current market price and also the class or classes of directors or employees to whom they are to be

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such shares as have been forfeited for non-payment of calls (sub-section (5)). *See also* sub-section (4) which imposes penalty for default. Evidentiary value of the contents of the return is that they are presumed to be true until the contrary is shown. *Om Prakash Berlia* v *Unit Trust of India*, (1983) 54 Comp Cas 136 Bom.

11 *Ooregum Gold Mining Co of India* v *Roper*, 1892 AC 125: 66 LT 427.

12 *Sandys, ex p*, (1889) 42 Ch D 98: 61 LT 94.

13 *Moselv* v *Koffyfontein Mines Ltd*, [1904] 2 Ch 108: 91 LT 266.

14 LINDLEY LJ in *Licensed Victuallers' Mutual Trading Assn, Re*, (1889) 42 Ch D 1 at 7: 60 LT 684 CA.

15 In *Mare Steel Castings (P) Ltd, Re*, [1993] 2 Comp LJ 261 CLB Mad, the CLB permitted discount upto 25%, which was feasible and also viable in the interest of the company. The Company Law Board in *Jersey (India) Ltd, Re*, (1997) 88 Comp Cas 854 CLB permitted a discount of more than 10% for issue of non-cumulative convertible preference shares. The issue was in the interest of the company. The conditions imposed were that promoters' holding was not to be increased, converted equity shares were to be listed within ten weeks.

16 *Proviso* to sub-s.(3) introduced by the Companies (Second Amendment) Act, 2002.

issued and consideration for the sweat equity shares proposed to be issued. At least one year must have elapsed between the commencement of business by the company and the date of such issue. Such shares shall be issued in accordance with SEBI Regulations. Where the shares are not listed at a stock exchange, they can be issued as sweat equity in accordance with the guidelines which may be prescribed.

The first *Explanation* to the section says that for the purposes of the section, the expression "company" means a company incorporated, formed and registered under the Companies Act and includes a subsidiary company incorporated in a country outside India. The second *Explanation* says that the expression "*sweat equity shares*" means equity shares issued at a discount or for consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatsoever name called.

Shares issued as sweat equity shares are to be treated for all purposes like other shares and, therefore, all the limitations, restrictions and provisions relating to equity shares will be applicable to them.[17]

UNDERWRITING COMMISSION [S. 76]

The second exception is in favour of underwriting commission. Section 76 allows a company to pay commission to any person for his subscribing or agreeing to subscribe for shares or debentures or for procuring or agreeing to procure subscription for shares or debentures of the company. When shares are offered to the public the company would naturally like to ensure success of the issue. The company may, therefore, make an agreement with financial institutions who, in consideration of the commission, agree to subscribe for the shares to the extent to which they are not taken up by the public. The agreement may be limited to a "certain number of shares if and so far as not applied for by the public".[18] Underwriting is now compulsory for the full issue and minimum requirement of 90% subscription of the portion offered to the public is also mandatory for each issue of capital to public.[19]

Underwriting commission can be paid subject to the following conditions:[20]

1. The payment of the commission must be authorised by the articles.
2. The rate of commission should not exceed five per cent of the price at which the shares are issued or any less amount prescribed by the articles. In the case of debentures it should not exceed 2.5%.

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17 S. 79-A(2).

18 Lord TOMLIN in *Australian Investment Trust Ltd* v *Strand & Pitt Street Properties Ltd, Re*. 1932 AC 735 at 745 PC. An underwriter does not guarantee the success of the prospectus. He only agrees to take those shares which would not be taken by the public.

19 *See* Section D of SEBI Guidelines for Disclosure and Investor Protection, 1992 and SEBI Underwriter Rules and Regulations, 1993. Managers to the issue must satisfy themselves of the net worth of the underwriters. Model underwriting agreements have also been prescribed.

20 S. 76(1).

3. The rate should be disclosed in the prospectus or statement in lieu of prospectus.
4. The prospectus should also indicate the number of shares or debentures which have been underwritten.
5. A copy of the underwriting contract should be delivered to the Registrar along with the prospectus.[21]

The effect of an underwriting agreement is that it is not merely a guarantee, but also an application for shares which are not taken up by the public. Hence the company can allot shares in terms of the contract without further application.[22]

BROKERAGE

The Act, however, permits such brokerage to be paid as has been lawful for a company to pay.[23] It has been recognised in *Metropolitan Coal Consumers' Assn* v *Scringeour*[24] that reasonable brokerage should always be allowed. In that case a commission of two and a half per cent to brokers was held to be reasonable. Brokerage is different from underwriting commission. A broker does not undertake to subscribe for shares to the extent of public default. Brokers are professional men, such as "stock-brokers, bankers and the like, who exhibit prospectuses and send them to their customers, and by whose mediation the customers are induced to subscribe".[25] Thus brokerage can be paid only to a person who carries on the profession of a broker and not to a person who has casually induced others to subscribe. Thus in *Andreae* v *Zinc Mines of Great Britain*:[26]

> There was an agreement to pay commission for sale of shares to a lady who was not carrying on any business, the court held: "It cannot be suggested that what was to be paid to the plaintiff was brokerage. She was in no sense a broker. She did not carry on business as a broker, and it was a mere accident that she came into the company's office and was consulted in this matter."

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21 The section now clearly forbids the payment of commission on any shares which are not offered to the public, except where a person has agreed to subscribe for shares before the prospectus is issued. *See* sub-section (4-A). Sub-section (5) imposes penalty for breach of the section.

22 *Pioneer Co* v *Kaithal Cotton & General Mills*, (1970) 40 Comp Cas 562: [1970] 2 Comp LJ 123 P&H. The underwriter may relieve himself of the burden by entering into sub-under writing contracts on the same basis. The sub-underwriter becomes bound to the company in the same way as the original underwriter.

23 S. 76(3). The business of brokers is now under the regulations framed by SEBI; Rules and Regulations for Brokers and Sub-Brokers, 1992 and Guidelines for Foreign Brokers. Brokers who play the role of market makers of companies have to observe SEBI Guidelines for Market Makers.

24 [1895] 2 QB 604: 73 LT 137.

25 BAILHACHE J in *Andreae* v *Zinc Mines of Great Britain Ltd*, [1918] 2 KB 454. By agreeing to "place" the company's shares the broker does not become a shareholder. *Monarch Insurance Co, Re*, (1873) 8 Ch App 507.

26 *Ibid.* Brokerage to a firm of managing agents has been held to be improper, that being not their business. *CIT* v *Balasundaram & Co*, (1980) 10 Tax LR 1136 Mad.

ISSUE OF SHARES AT PREMIUM [S. 78]

If the market exists, a company may issue its shares or securities at a price higher than their nominal value.[27] There is no restriction whatever on the sale of shares at a premium. But SEBI Guidelines have to be observed as they indicate when an issue has to be at par and when premium is chargeable.[28] Premium may be received in cash or in kind. Where the value of the assets received by a company as a consideration for allotment is greater than the nominal value of shares, it is in essence an allotment at a premium. An amount equal to the extra value of assets would have to be carried to the share premium account.[29] The Act does regulate the disbursement of the amount collected as premium. It is clearly provided that the amount so received, whether in cash or kind, shall be carried to a separate account to be known as the *The Securities*[30] *Premium Account*. The amount to the credit of share premium account has to be maintained with the same sanctity as share capital and can be reduced only in the manner of share capital.[31] Liberty is, however, given to use the fund in the following four ways:[32]

1. It may be applied to issue to the members as fully paid by way of bonus the unissued shares of the company.
2. It may be used to write off preliminary expenses.
3. It may be used to write off commission or discount account.
4. It may be spent in providing for the premium payable on the redemption of preference shares or debentures of the company.

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27 It is not necessary that there should be authority in the company's articles for this purpose.

28 SEBI Guidelines for Disclosure and Investor Protection, Section A: Issue when to be at par and when premium chargeable.

29 *Head (Henry) & Co Ltd* v *Ropner Holdings Ltd*, [1952] Ch 124.

30 Substitutes for the word "shares" by the Companies (Amendment) Ordinance, 1999, w.e.f. Oct 31, 1998.

31 See, *Thorn EMG plc*, 1989 BCLC 812 Ch D; *Tip-Europe Ltd*, 1988 BCLC 231 Ch; *Rainers Group plc, Re*, 1988 BCLC 231, all on reduction share premium account. The decision of the Court of Appeal in *Ransames plc*, [1999] 2 BCLC 591 CA, affirmed the decision of the court below in sanctioning reduction of share premium account irrespective of irregularities like short notice of meeting, increasing the number of shareholders to assure smooth passage of the resolution and highly abbreviated notice, because the interests of the shareholders were not prejudiced there being otherwise good resources for paying them back in full in case of need.Dividends cannot be paid out of the premium amount, *Drown* v *Gaumont-British Picture Corpn Ltd*, (1937) Ch 402; *Duffe Settlements, Re*, (1951) Ch 923 CA; *Shearer* v *Bercain*, (1980) 3 All ER 295; *Head (Henry) & Co Ltd* v *Ropner Holdings Ltd*, [1952] Ch 124. shares of extra value received on merger, not allowed to be used for being distributed as dividend.

The amount to the credit of the share premium account has to be shown as a separate item in the Balance-sheet and if it was disposed of, wholly or partly, how it was disposed of (Sch VI, Part I). The Department of Company Affairs is of opinion that the amount of premium cannot be treated as a free reserve as it is in the nature of a capital reserve. Circular No 3/77 of 15-4-1977.

32 S. 78(2). It has been held by the Supreme Court that a company may charge varying premiums in respect of blocks of shares having the same rights issued under different resolutions, and "on principle there is no objection to the charging of varying rate of premium for shares issued under a single resolution, if all the parties concerned agree". *CIT* v *Standard Vaccum Oil Co*, [1966] 1 Comp LJ 187, 192: AIR 1966 SC 1393.

PENALTY FOR FRAUDULENTLY INDUCING INVESTMENT [S. 68]

The provision in Section 68 is as follows:

"Any person who, either by knowingly or recklessly making any statement, promise or forecast which is false, deceptive or misleading, or by any dishonest concealment of material facts, induces or attempts to induce another person to enter into, or to offer to enter into—

(*a*) any agreement for, or with a view to, acquiring, disposing of, subscribing for, or underwriting shares or debentures; or

(*b*) any agreement, the purpose or pretended purpose of which is to secure a profit to any of the parties from the yield of shares or debentures, or by reference to fluctuations in the value of shares or debentures;

shall be punishable with imprisonment for a term which may extend to five years, or with fine which may extend to ten thousand rupees, or with both."

Prospectuses offering securities under concealment of vital facts would be within the mischief of this section.[33]

PERSONATION FOR ACQUISITION OF SHARES [S. 68-A]

This provision has been introduced by the Companies (Amendment) Act, 1965. The purpose of the section is to prevent allotment of shares in fictitious names. Accordingly, no application should be made to a company for acquiring or subscribing for any shares in a fictitious name. Similarly, no one should induce a company to allot, or register any transfer of, shares in a fictitious name. The penalty for this offence is a term of imprisonment which may extend to five years.

Every company which issues a prospectus is required to reproduce prominently the provisions of the section in the prospectus and application forms.

A person who gets shares allotted in a fictitious name becomes liable as a shareholder. Thus where a person carried on business under an assumed name and took shares in that name, his trustee in bankruptcy could not avoid liability.[34]

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33 *M. K. Srinivasan, Re*, AIR 1944 Mad 410: (1944) 14 Comp Cas 193. Power of prosecution under the section has been delegated to SEBI. *Sundaram Finance Services Ltd* v *Grand trust Finance Ltd*, (2002) 112 Comp Cas 361 Mad. a prosecution launched under the section. *A. V. Mohan Rao* v *M. Kishan Rao*, (2002) 111 Comp Cas 390: (2002) 6 SCC 174: 2002 SCC Cri 1281, huge sums of money were collected under a document described as "project overview" by NRIs but shares not allotted in the proposed joint venture company instead the money was diverted to some off-shore companies controlled by the accused persons, offence under Sections 60, 63, 68, 68-A, 621 *prima facie* made out.

34 *Central Klondyke Gold Mining Co, Re*, (1899) WN 1.

8

Shareholders and Members

The words "member" and "shareholder" are used interchangeably and, generally speaking, apart from a few exceptional cases, they are synonymous. There are, for example, companies limited by guarantee or unlimited companies, which may not have share capital and, therefore, can have no shareholders, but they do have members. Contrarily, the bearer of a share warrant is a shareholder, but not a member, as his name is struck off the register of members.[1]

Definition of member [S. 41]

Section 2(27) talks of a member in relation to a company and says that the expression does not include a bearer of a share warrant of the company issued in pursuance of Section 114. This is an exclusion clause rather than a definition. The real definition is to be found in the provisions of Section 41 and here the emphasis in both the sub-sections is entry in the register of members. Here is what the section says:

41. *Definition of "Member"*—(1) The subscribers of the memorandum of a company shall be deemed to have agreed to become members of the company, and on its registration, shall be entered as members in its register of members.

(2) Every other person who [2][agrees in writing] to become a member of a company and whose name is entered in its register of members, shall be a member of the company.

(3) Every person holding equity share capital of a company and whose name is entered in as beneficial owner in the records of the depository shall be deemed to be a member of the concerned company.

In reference to the subscribers of the memorandum, the section ordains that they shall be entered as members in the register of members and in reference to others the section prescribes that there should be an application in writing and the name should be there in the register of members. The words "agreed in writing" were brought in by the amendment of 1960 so as to prevent in the circumstances of our country a person being surprised by the presence of his name in the register and then facing the burden of a *prima facie* evidence and leading evidence to show that he never agreed to be a member. In either case the section requires as a condition of membership that the name of the person in question is there in the register of members. But even so the courts have ruled that the wider definition of membership in Section 2(27) as excluding only warrant holders, cannot be curtailed by Section 41 and, therefore, a person may be regarded as a member if he has acquired the right of membership though his name is not in the register[3] and a person whose name is in the register may not be regarded as a member if he did not agree to be a member in writing or is not accepting his position as such.[4]

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1 S. 115(1). But the articles of association of a company may provide that in all or some respects the bearer of a share warrant may be deemed to be a member. S. 115(5).

2 *Subs.* by Act 65 of 1960, S. 13, for "agrees".

3 *N. Satyaprasad Rao* v *V. L. N. Sastry*, (1988) 64 Comp Cas 492 AP.

4 *Shri Balaji Textile Mills (P) Ltd* v *Ashok Kavle*, (1989) 66 Comp Cas 654, 661-662 Ker. This is more true of English law where the words "in writing" are not used. See *Nuneaton Borough*

Shares can be held jointly. The principles relating to rights and liabilities under joint promises would apply. Where one joint holder died and the shares were registered in the name of the surviving joint holder, that was held to be justified though the legal heirs were claiming registration in their name.[5]

A consequential amendment of Section 41 made by the Depositories Act provides that a person holding the equity share capital of a company and whose name is entered as a beneficial owner in the records of a depository is a member of the company. Holding equity shares through a depository constitutes the holder into a member.[6] A person who holds shares in a demat form, his name does not appear in the company's register of members.

How to become a member

One may become a shareholder in a company in any one of the following ways:

1. By subscribing to memorandum [S. 41]

In the first place, Section 41 of the Act provides that the subscribers of the memorandum of association shall be deemed to have agreed to become the members of the company, and on its registration shall be entered as members in the register of members. Accordingly, it was held in *Official Liquidator* v *Suleman Bhai*[7] that:

> The subscriber of the memorandum is to be treated as having become a member by the very fact of subscription. Neither application form, nor allotment of, shares is necessary. Even an absence of entry in the register of members cannot deprive him of his status. He acquires, as soon as the company is registered, the full status of a member with all the rights and liabilities.
>
> The facts were that one *S* had subscribed the memorandum of a company for 200 shares. The company was duly registered, but he ultimately took only 20 shares. He was held liable in the winding up of the company to pay for all the 200 shares although they were, in fact, never allotted to him.[8]

Association Football Club Ltd, Re, 1989 BCLC 454 CA; *National Steel & General Mills* v *Official Liquidator*, [1989] 2 Comp LJ 214 Del; (1990) 69 Comp Cas 416, continuity of membership. *See* further *Ram Kishan* v *Kanwar Paper (P) Ltd*, (1990) 69 Comp Cas 209 HP, where the name was ordered to be removed from the register because there was no agreement in writing.

5 *Jayalakshmi Acharya* v *Kal Electronics and Consultants (P) Ltd*, (1997) 90 Comp Cas 200; *Kamla Pal* v *Esso Standard Refining Co (P) Ltd*, [1997] 3 Comp LJ 138 CLB.

6 S. 41(3).

7 AIR 1955 MB 166.

8 *Evan* case, (1867) 2 Ch App 427, 431; *Migott* case, (1867) LR 4 Eq 238, where it was held that an allotment to the subscriber of fully paid shares belonging to another is not enough. There is, however, the case of *Synemodelux Ltd* v *K. Vannamuthu Pillai*, AIR 1939 Mad 498, decided by the Madras High Court, where it was held that an express allotment of shares to the subscriber is necessary to make him liable. It appears that proper authorities were not cited before the Court. If the subscriber pays by transferring assets (non-cash payment) expert valuation report would be needed.

2. Qualification shares [S. 266]

Under the Companies Act no person is capable of being appointed a director of a public company unless he takes, or signs and files with the Registrar an undertaking to take, from the company his qualification shares, if any.[9] Such directors who have signed an undertaking to take and pay for their qualification shares are also in the same position as subscribers of the memorandum.[10] They are also deemed to have become members automatically on the registration of the company.[11]

Where, however, a director fails to take his qualification shares and his office falls vacant automatically on the expiry of the prescribed time, his name, in the view of the Bombay High Court, cannot be placed on the list of contributories.[12]

3. By allotment

A person may become a shareholder by agreeing to take shares in the company by allotment.[13]

4. By transfer

One may purchase shares of a company in the open market and then apply to the company to register him as a member. Section 41 which defines "member" says that it includes the subscribers to the memorandum of a company and every other person who agrees in writing to become a member of the company and whose name is entered in its register of members. Thus it requires two things: (*a*) an agreement in writing to become a member and (*b*) an entry in the register.[14]

5. By transmission

On the death of a member his executor or the person who is entitled under the law to succeed to his estate gets the right to have the shares transmitted to his name in the company's register of members. Transmission is different from transfer. Section 108 which lays down the formalities of transfer specially provides that nothing in the section shall prejudice the power of the company to register as shareholder any person to whom the right to any shares has been transmitted by operation of law.[15] It follows that an instrument of transfer is not

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9 S. 266(1)(*b*). Alternatively, he may sign the memorandum for his qualification shares in which case he will become member by subscription. Sub-section 1(*a*)(*i*).

10 S. 266(2).

11 *See also* sub-section (5) which contains exceptions which are that the section will not apply to companies not having a share capital, a private company, or which was private before becoming a public company or the issue of a prospectus one year from the date from which the company was entitled to commence business.

12 *Zamir Ahmed* v *D. R. Banaji*, AIR 1958 Bom 198: (1957) 27 Comp Cas 634: 59 Bom LR 591.

13 For details as to allotment, *see* the preceding Chapter.

14 The Kerala High Court has emphasised in *Lalithamba Bai* v *Harrisons Malayalam Ltd*, (1988) 63 Comp Cas 622, 666 the importance of the fact of "agreement in writing" by holding that it must be proved and that an agreement for taking over the assets of a company does not have the effect of taking over its shares from its members.

15 S. 108(1), 2nd proviso. It may be necessary to submit a succession certificate, but vesting takes place from the moment of death and not from the date of the grant of certificate. *Margaret T.*

necessary. No formalities like transfer deed, execution, attestation and stamp duty are needed. Legal heirs as shown by the succession certificate are aggrieved persons entitled to seek relief against refusal.[16] Provisions relating to formalities of transmission are generally found in the company's articles. Clauses 25 to 28 of Table A contain such provisions. If the company unduly refuses to accept a transmission, the same remedies are available as in the case of a transfer, namely, an appeal to the Company Law Board under Section 111. The refusal by directors to accept a transmission has been held to be appealable to the CLB under Section 111-A(2).[17] A company's refusal to accept a transmission unless a succession certificate is produced has been held to be a refusal enabling the legal heir to file an appeal against it. A succession certificate obtained after death would apply not only to transmission but also to bonus shares, dividend, interest and other benefits accruing to the shares. A fresh certificate is not necessary for such benefits.[18]

The new provisions relating to transfers are equally applicable to transmissions.[19]

Where the company had accepted transmission in respect of a part of the shares but demanded succession certificate or probated 'will' in respect of the rest of the shares, the CLB held that the company had lost the right to refuse transmission for all the shares. No other person had raised any claim or objection.[20] Thus, for example, in a case before the Supreme Court, the State of Orissa became entitled by devolution to the shares of a *Maharaja*, but the company refused to register the State's representative as a shareholder. BACHAWAT J held that the State became entitled to the shares by operation of law. It was, therefore, a case of transmission and the company was bound to accept the same.[21] A company was not allowed to refuse the registration of

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Devor v *Worldwide Agencies (P) Ltd*, (1989) 66 Comp Cas 5 Del; the Supreme Court affirmation on other points, *Worldwide Agencies P Ltd* v *Margaret*, (1990) 1 SCC 536: 1990 SCC (Tax) 171: (1990) 67 Comp Cas 607 SC: AIR 1990 SC 737: [1990] 1 Comp LJ 208.

16 *Kamlabai* v *Vithal Pd Co (P) Ltd*, (1993) 77 Comp Cas 231 Kar. Succession certificate or letters of administration would be necessary, particularly where there is no agreement among known legal heirs. *Narinder Kumar Sehgal* v *Leader Valves Ltd*, (1993) 77 Comp Cas 393 CLB, relying upon *Kasi Vishwanathan Chettiar* v *Indo Burma Petroleum Co Ltd*, (1936) 6 Comp Cas 42 Rang. Where it was certain that the widow was the sole surviving heir, insistence upon succession certificate was held to be not justified. The shareholding being established otherwise also, production of share scrips may also be not necessary. *Simret Katyal* v *Mahavir Ice Mills (P) Ltd*, (1995) 83 Comp Cas 699 CLB. For effecting a transmission, the procedure prescribed by the Act and the company's articles has to be followed, *Anand Hemani Patel* v *Ornate Club (P) Ltd*, (2000) 99 Comp Cas 6 CLB.

17 *Anil R Chhabria* v *Finolex Industries Ltd*, (2000) 99 Comp Cas 168.

18 *Arjun Kumar Israni* v *Cipla Ltd*, (2000) 99 Comp Cas 237 (CLB-WB). *Khurshid Alam* v *P. Pagnon Co P Ltd*, (2002) 108 Comp Cas 523 CLB. shares stood in the name of a deceased Mohammedan, son applied for transmission, he produced his father's will favouring him, other legal heirs did not object, the company was held not justified in insisting upon probate or letters of administration.

19 *Finolex Industries Ltd* v *Anil Ramchand Chhabria*, (2000) 26 SCL 233 Bom, not approving the ruling of the CLB in *Sashi Prakash Khemka* v *NEPC Micon Ltd*, (1999) 95 Comp Cas 583 CLB.

20 *Nandita Bhardwaj* v *Sapphire Machines (P) Ltd*, [2000] 2 Comp LJ 109 CLB.

21 *Indian Chemical Products Ltd* v *State of Orissa*, AIR 1967 SC 253: [1966] 2 Comp LJ 63:

transmission in favour of the legal heir of a deceased member on the ground that he was carrying on a competing business.[22]

The executor or the successor also has the right to transfer the shares. Section 109 specially enables the legal representative to effect a transfer even if he is not a member himself. Thus he has an option. But he must decide within a reasonable time. The directors may require him by notice to make up his mind within 90 days and if the notice is not complied with, payments due on the shares may be withheld, until the notice is complied with.[23]

In the above three cases, a person does not become a member unless his name is entered in the company's register of members.[24]

Nomination of shares and debentures [S. 109-A]

This newly introduced section[25] provides the facility to shareholders, etc., to register the name of any person with the company in whom the shares will be vested on the death of the nominating shareholder. Debenture holders and depositors have also been given similar rights. Nomination can be filed at any time in a manner to be prescribed.[26] Joint holders can also nominate any person for the purpose of vesting of shares in the event of the death of all the joint holders.[27] Such nomination will supersede the law of succession and any 'will' or disposition whether testamentory or otherwise. The shares or debentures will be vested in the nominee to the exclusion of any claimant whether under 'will' or succession. The only process by which any change can be brought about is that the security holder should himself change the nomination.[28] Where the nominee is a minor, the security holder may suggest any other name in the prescribed manner in whom the shares would be vested should the nominee die during his minority.[29]

Transmission of shares under nomination [S. 109-B]

The nominee gets the right on the death of the security holder to register himself as the security holder or transfer the securities. His right of transfer will be subject to the same limits and restrictions as the right of the original security holder was. The Board of directors will have the same right of refusal as would have been there had the securities been transferred by the original holder.[30] Sub-section (7) has been inserted by the Companies (Amendment) Act, 1999 to make

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(1966) 36 Comp Cas 592. *See* also *M. K. Sugar Mills* v *I. K. Sugar Mills*, AIR 1965 All 135: (1963) 33 Comp Cas 1142, where the matters relating to transmission are explained, *see* at 140.

22 *S. M. Hajee Abdul Sahib* v *KNS Co (P) Ltd.* (1998) 91 Comp Cas 843 CLB. Rectification of register of members was ordered. *Debasish Dutta* v. *B. G. Somadder & Sons P Ltd*, (2003) 115 Comp Cas 70 (CLB), company directed to register legal heirs under transmission.

23 Clause 20 (proviso), Table A, Schedule I.

24 Section 116 provides penalty for impersonation of shareholder. For a statement of the formalities of a transmission see *UTI* v *Om Prakash Berlia*, (1983) 54 Comp Cas 723 Bom; *Killick Nixon Ltd* v *Dhanraj Mills (P) Ltd*, (1983) 54 Comp Cas 432 Bom.

25 Added by the Companies (Amendment) Act, 1999.

26 S. 109-A(1).

27 S. 109-A(2).

28 S. 109-A(3).

29 S. 109-A(4).

30 S. 109-B(2).

it clear that the Board of directors will have no right to decline or suspend registration of transfer in the event of nomination of a shareholder in favour of a nominee. If the nominee wants to register himself as the holder he should send to the company in writing a notice under his signature accompanied by the death certificate. Since this also amounts to a transfer, it will be under the same restrictions which would have been applicable as if the original holder had made a transfer.[31] Even before he gets himself registered, he will be entitled to all the advantages as to dividend, etc., but unless he gets himself registered as a holder, he will have no right in relation to the meetings of the company.[32] If he does not exercise his right of becoming a security holder or of transferring the securities, the Board of directors may ask him to regularise the matter. If he does not do so within 90 days of the receipt of notice, the company may deny him the benefit of dividend, bonus or moneys becoming payable in respect of the shares.[33]

Who may be a member

Minor

Every person who is competent to contract may become a member. A minor and a person of unsound mind, being incompetent to contract, cannot be members of a company.[34] According to English law, however, a minor may join a company as a member, but the contract is voidable at his option during minority as well as within reasonable time after the attainment of majority.[35] But as long as it is not avoided it is a valid contract.

In India also a minor may be allotted shares. His name may remain on a company's register of members, but during minority he incurs no liability. In *Palaniappa* v *Official Liquidator*:[36]

> Shares were allotted to a minor on an application signed on her behalf by her guardian. In the winding up of the company neither the minor nor her guardian were held liable as contributories.

On attaining majority and becoming aware of the presence of his name in the register of members, the minor has the option to repudiate his shares within a reasonable time. Where he does not do so he may safely be taken to have accepted his position. His liability as a shareholder commences. This was laid down by the Bombay High Court in *Fazulbhoy Jaffar* v *Credit Bank of India Ltd.*[37]

> An infant was registered as a shareholder. After attaining majority he received dividends from the company. The Court observed: "Under these circumstances it cannot be doubted that he has intentionally permitted the company to believe him to be a shareholder and in that belief to pay him dividends since he attained majority. He is, therefore, estopped now by his

31 S. 109-B(3 and 4).
32 S. 109-B(5).
33 *Ibid.*
34 Ss. 10 and 11 of the Indian Contract Act, 1872.
35 *Steinberg* v *Scala (Leeds) Ltd.*, [1923] 2 Ch 452: [1923] All ER Rep 239, where the minor was released from further liability but refund of what he had already paid was not allowed.
36 AIR 1942 Mad 470: [1942] 1 MLJ 425: 201 IC 731.
37 AIR 1914 Bom 128: ILR 39 Bom 331: 27 IC 335.

conduct from denying that he is a shareholder.'' The company was in winding up.[38]

The erstwhile Companies Tribunal held in *Navin Chandra* v *Gordhandas*[39] that if a minor's name is entered in the register of members as an allottee, the company cannot afterwards *suo motu* delete it and the minor is entitled to rectification if the company does so. The Delhi High Court in *Golcunda Industries Ltd* v *ROC*[40] has held that the Registrar of Companies cannot refuse to accept a return as to allotment in which a minor is shown as an allottee. The court agreed that the whole law relating to a minor joining a company is still uncertain. There is nothing in the Companies Act prohibiting a minor from becoming the member of a company. Section 41(2) read with Article 19(1) of Table A indicates that the agreement in writing can be made by the guardian on behalf of the minor. It will not be a case of a trust because the minor's name will be entered in the register of members. The shares being fully paid, he would incur no liability.[41]

Others Disqualified

Others disqualified would include, for example, persons of unsound mind and insolvents. The position of a person of unsound mind is akin to that of a minor. So far as an insolvent is concerned, if he was a member before, his name can remain in the register notwithstanding his insolvency, unless the articles provide otherwise. The changes which occur under insolvency laws as to his position as a shareholder are only these that the beneficial interest in the shares would be vested in his assignee, who would also control voting rights. In all other respects he can exercise the normal membership rights, for example, the right of instituting a minority action for redressing corporate wrongs.[42]

Company as Member

A company, being a legal person, may become the member of another company. But a company can invest money in another company only if it is so authorised by its memorandum of association.

A company cannot, however, buy its own shares, except in a limited manner permitted by Section 77. Similarly, subject to a few exceptions given in Section 42, a company cannot buy shares of its holding company. Restrictions on inter-corporate investments are stated in Section 372.

Trade Union

A trade union registered under the Trade Unions Act, can be registered as a member and can hold shares in a company in its own corporate name.[43]

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38 *See* also *Yeoland Consols, Re, (No 2)*: (1888) 58 LT 922.

39 [1967] 1 Comp LJ 82: (1967) 37 Comp Cas 747.

40 AIR 1968 Del 170.

41 *Gautam R. Palival* v *Karnataka Theatres Ltd*, [2000] CLC 1765 CLB, following *R. Balaraman* v *Buckingham & Carnatic Co Ltd*, [1969] 1 Comp LJ 81 CLB.

42 See *Morgan* v *Gray*, [1953] Ch 83; *Birch* v *Sullivan*, [1957] 1 WLR 1247.

43 *All India Bank Officers Confederation* v *Dhanlakshmi Bank Ltd*, (1997) 90 Comp Cas 225: [1997] 3 Comp LJ 132: (1997) 26 Corpt LA 33 CLB.

Partnership

A partnership firm, not being a person, cannot buy shares in its own name. It may buy shares as a part of the assets of the firm, though they will have to be held in the name of individual partners. A firm may be a member of any association or company licensed under Section 25 as a charitable institution, but it shall cease to be a member on its dissolution. [S. 25(4)].

Ceasing to be member

A person may cease to be a member by transfer, death, forfeiture, surrender, on winding up of the company and otherwise in accordance with the provisions of the company's articles of association.

Liability of members

Liability of members depends on the nature of the company. If the company is registered with unlimited liability, every member is liable in full for all the debts of the company contracted during the period of his membership.[44] Where the company is limited by guarantee, each member will be bound to contribute in the event of winding up a sum of money specified in the liability clause of the memorandum of association.[45] Most companies are, however, incorporated with the liability of members limited by shares. Each member is bound to contribute the full nominal value of his shares and his liability ends there.

Calls on shares

The liability of a shareholder to pay the full value of the shares held by him is enforced by making "calls" for payment. Every shareholder is under a statutory liability to pay the full amount of his shares as Section 36(2) declares that "all money payable by any member to the company... shall be a debt due from him to the company". But the liability to pay this debt arises only when a valid call has been made. For example, in *Pabna Dhana Bhandar Co Ltd* v *Foyezud Din Mia*:[46]

> It was held that "a mere demand by a company acquiring the rights of another company in respect of its uncalled capital cannot take the place of a formal call".

However, according to Section 92 a company can accept voluntary payment of the uncalled amount, if it is so authorised by its articles. Voting rights are, however, regulated only by the amount actually called by the company.

An enforceable call shall have to conform to the provisions of the Act and the articles of association of the company. The following are some of the important requisites of a valid call:

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44 *See* "Unlimited Companies," *infra*, Ch. 19 and S. 12(2)(c).

45 *See* "Guarantee Companies", *infra*, Ch. 19 and S. 12(2)(6), and *Stadmed (P) Ltd* v *Kshetra Mohan*, AIR 1968 Cal 572: [1968] 1 Comp LJ 321: 72 CWN 601.

46 AIR 1932 Cal 716: 140 IC 252: 36 CWN 589.

1. *By resolution of board*

In the first place, a call must be made under a resolution of the Board of directors.[47] "In making a call care must be taken that the directors making it are duly appointed, and duly qualified, and that the meeting of the directors has been duly convened, that the proper quorum is present and that the resolution making the call is duly passed."[48] However, every small irregularity should not be taken to render a call invalid. To cover minor discrepancies the articles often provide that the acts of directors would be valid notwithstanding that it should be afterwards discovered that there was some defect in the appointment or qualifications, etc. of such directors. Accordingly, in *Dawson* v *African Consolidated Land & Trading Co*,[49] where a clause of this kind existed, it was held that a call made by a resolution of three directors was valid, although one of them had under the articles of association vacated his office by parting with all his qualification shares for a few days. *Shiromani Sugar Mills Ltd* v *Debi Prasad*[50] is another illustration:

> The directors had by not paying allotment and call moneys disqualified themselves, yet their act in making a call was held to be valid.[51]

Section 92 gives the company the power, if so authorised by its articles, to 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. Such payment will not entitle the member to more voting rights as compared with other members until all have been called upon to pay.[52]

2. *Amount and time of payment*

Secondly, the resolution must state the amount of the call and the time at which it is to be paid, otherwise the call will be invalid. In *E&W Insurance Co Ltd* v *Kamala Mehta*:[53]

> The directors of a company had, by two resolutions, resolved to make a call. But neither resolution specified the date and the amount of payment. The blanks were subsequently filled by the secretary, who sent a notice of call to the defendant. The call notice was held to be invalid.[54]

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47 Accordingly, the High Court of Bombay held in *E&W Insurance Co* v *Kamala Mehta*, AIR 1956 Bom 537 that "such an important power which is vested in the directors could not be delegated by them to any one and could not be exercised by any one"... but if they do not wish to do what the articles require them to do and leave the doing of it to someone else, they must clearly resolve to that effect.

48 Palmer's COMPANY LAW, 318 (20th Edn, 1959).

49 [1898] 1 Ch 6: 77 LT 392.

50 AIR 1950 All 508: (1950) 20 Comp Cas 296: 1950 ALJ 836.

51 Ordinarily this should have been regarded a breach of trust and the directors should be compelled to pay as much as other shareholders had paid. See *Alexander* v *Automatic Telephone Co*, [1900] 2 Ch 56: [1900-03] All ER Rep Ext 1755.

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

53 AIR 1956 Bom 537.

54 *See* also *Cawley & Co, Re*, (1889) 42 Ch D 209: 61 LT 601, where it was held that in such cases there is no proper call made until the directors pass a second resolution fixing the date of

3. *Bona fide in interest of company*

Thirdly, the capital of a company is a trust fund in the hands of directors. The amount called up must be used scrupulously for the objects of the company and the amount uncalled must be called only when it is necessary for the promotion of those objects. Hence the power to make a call is in the nature of a trust and is to be exercised in the interest of the company. Good faith is lacking where, without paying what is due on their own shares, the directors call upon the other shareholders to pay. In such a case the court would require them to pay as others have paid.[55] Similarly, where the directors paid into the company's account the amount due on their shares and immediately thereafter withdrew it as their fee, it was held that the payment was not for the benefit of the company and they remained liable to pay.[56]

4. *Uniform basis*

Section 71 provides that "calls shall be made on a uniform basis on all shares falling under the same class". Hence a call cannot be made on some of the members only, unless they constitute a separate class of shareholders. Thus where a shareholder paid the first two calls after a great delay and neglected to pay the third call and the directors, being annoyed, called upon him to pay the whole amount due, the call was held to be invalid.[57] But "shares of the same nominal value on which different sums have been paid shall not be deemed, for this purpose, to fall under the same class."[58]

A shareholder on whom a regular call for payment has been served may choose to pay the sum due in respect of only a part of his shares. In the view of the Punjab High Court the debt is not "an entire and indivisible debt", and, therefore, the company may be bound to accept the amount tendered by the shareholder.[59]

Payment in kind (*Payment by non-cash consideration*)

Shares may be paid for in cash or kind or in any manner that has the effect of actual cash being received by the company. In *Larocque* v *Beauchemin*:[60]

> A company purchased a paper mill for 35,000 dollars payable in cash. Subsequently, however, the vendors purchased shares in the company and allowed it to retain a part of the sale proceeds in payment of the shares.

It was held that the effect of the agreement was that the shares had been paid in full in cash as it was not necessary that the company should first receive the share money and then hand it back to the vendor in payment of its debt. Similarly, the company may allow a shareholder set-off for the amount due to

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payment. To the same effect is *Major Teja Singh* v *Liquidator of Hindustan Petroleum Co Ltd*, (1961) 31 Comp Cas 573.

55 *Alexander* v *Automatic Telephone Co*, [1900] 2 Ch 56: [1900-03] All ER Rep Ext 1755.

56 *European Central Rail Co, Re*, (1872) LR 13 Eq 255: 26 LT 92.

57 *Galloway* v *Halle Concerts Society*, [1915] 2 Ch 233: [1914-15] All ER Rep 543.

58 *Explanation* to S. 91.

59 *Hind Iron Bank Ltd* v *Raizada Jagan Bali*, (1959) 29 Comp Cas 418. For a detailed account of the subject *see* M. S. Srinivasan, *Calls on Shares in Companies*, [1964] 1 Comp LJ 91.

60 1897 AC 358: 76 LT 473.

him against his liability to pay for his shares. Thus payment for shares may be in property, goods or services.[61]

Where shares are allotted for any consideration other than cash, that is to say, for purchase of property or in return for services, the company has to file with the Registrar[62] a copy of the contract in writing showing the title of the allottee or other consideration he gave for the shares.

This is necessary to prevent frauds inherent in a transaction of this kind by overvaluing the assets transferred to the company. Where the consideration is grossly inadequate or illusory or colourable or apparently less than the value of the shares allotted, the agreement is set aside and the allottee is ordered to pay for the shares in full.[63] Thus where a director was given 200 shares of £1 each in return for a loan of £100, it was held to be a colourable transaction to issue shares at a discount.[64] But, in the absence of a fraud in valuation, the court may not interfere only on the ground of inadequacy of consideration.[65] In *Alote Estate* v *R. B. Seth*:[66]

> Shares were allotted in return for sugarcane growing land transferred to the company. In the winding up of the company it was alleged that the value of the land was ten times less than the value of the shares allotted.

Even so GROVER J of the Supreme Court, refused to interfere. The learned judge said that there was no allegation of fraud. The facts stated related more to inadequacy of price or consideration and not to its being illusory. There should be no inquiry into the question whether the appellants had paid consideration which was inadequate.[67]

It has been held by the Madras High Court that shares cannot be allotted in consideration of promissory notes.[68]

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61 *Ooregum Gold Mining Co of India* v *Roper*, 1892 AC 125: 66 LT 427.

62 Within 30 days of the allotment, S. 75. Where the contract is not in writing, the prescribed particulars of the contract should be filed. Such particulars would be regarded as an instrument within the meaning of the Stamp Act, 1899. It would have to be stamped with the stamp duty as would have been payable if the contract were in writing and the Registrar may require that the duty payable be adjudicated under S. 31 of the Stamp Act.

63 *James Pilkin & Co, Re*, (1916) 85 LJ Ch 318. Also see *Derham & Allen Ltd, Re*, [1946] Ch 31; *Alote Estate* v *R. B. Seth*, (1970) 1 SCC 425, 429: AIR 1971 SC 920: (1970) 40 Comp Cas 1116.

64 *Ibid.*

65 *Hong Kong & China Gas Co Ltd* v *Glen*, [1914] 1 Ch 527: [1914-15] All ER 1002; *Wragg Ltd, Re*, [1897] 1 Ch 796: [1895-99] All ER Rep 398. *Punjab Distilling Industries* v *BPC Mills Ltd*, (1973) 43 Comp Cas 189 Del, shares allotted in consideration of out of date foreign machinery.

66 (1970) 1 SCC 425: AIR 1971 SC 920: (1970) 40 Comp Cas 1116.

67 Where shares were allotted to directors, on the company becoming a public company, for their past services in establishing the company and its business, they were held liable to pay the price in the company's winding up because past services are no consideration, *Eddystone Marine Ins Co, Re*, [1893] 3 Ch 9: 69 LT 363. An allotment of shares for a future service would be equally without consideration making the allottee liable to pay the price, *National House Property Investment Co Ltd* v *Watson*, 1908 SC 888, Scotland. A company may make immediate payment for hiring future services and then take back the money as consideration for shares, *Gardner* v *Iredale*, (1912) 1 CR 700.

68 *Chokkalingam* v *Official Liquidator*, AIR 1944 Mad 87: [1943] 2 MLJ 499.

FORFEITURE OF SHARES

If a member, having been called upon to pay, defaults, the company may, of course, bring an action against him. But articles of association often provide that in such a case the company may proceed to forfeit his shares. Shares cannot be forfeited unless there is a clear power to that effect in the articles. Thus in *Madhwa Ramchandra Kamath* v *Canara Bkg Corpn Ltd*:[69]

> The articles of a company only authorised it to expel a member. That was held to be not sufficient to enable the company to deprive the expelled member of his shares.

Forfeited shares become the property of the company. To this extent forfeiture involves a reduction of the company's capital. The shares can, however, be re-issued, even at a discount, but that is not the same thing as an allotment.[70]

"The right to forfeit shares must be pursued with the greatest exactness: it must be exercised by the proper parties, that is, by directors properly appointed, and by the requisite number of them and in the proper manner and for the proper cause. The right must be exercised *bona fide* for the purpose for which it is conferred. The power of expulsion is a trust the execution of which will be narrowly scanned by the courts."[71] The proper procedure to be observed in carrying out a forfeiture is as follows:

1. In accordance with articles

A forfeiture to be valid must proceed on the grounds specified in the company's articles. It seems to be a principle of English law that shares can be forfeited only for a non-payment of calls.[72] A call which does not fix the time for payment cannot support a valid forfeiture.[73] A forfeiture on any other ground

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69 AIR 1941 Mad 354. Regulations 29 to 35 of Table A provide for the power of forfeiture. If a company's original articles do not contain this power they may be amended so as to include the power.

70 *Calcutta Stock Exchange Assn, Re*, AIR 1957 Cal 438. Upon reissue the capital becomes intact. See *Calcutta Stock Exchange Assn* v *Nandy*, ILR 1950 Cal 235.

71 SHADI LAL J (as he then was), in *Kanshi Ram* v *Kishore Chand*, AIR 1915 Lah 109: 29 IC 567. The learned judge added: "It (the power of forfeiture) cannot, for example, 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." *See* also *Esparto Trading Co, Re*, (1879) 12 Ch D 191, where a forfeiture that appeared to have been carried out at the request of a shareholder to relieve him from liability was set aside. *Abdul Karim* v *Sirpur Paper Mills*, [1969] 1 Comp LJ 144.

72 *See*, for example, *Viswanath Prasad Jallan* v *Holyland Cinetone Ltd*, AIR 1934 All 739: 1939 ALJ 950, where it was held that where certain subscribers had undertaken to purchase a certain number of shares but there was no term in the articles of association by which they were to pay the amount on a particular date, nor was any date fixed by the board of directors, their shares were not liable to forfeiture. Similarly in *Panna Lal* v *Jagatjit D&A Industries*, AIR 1952 Pepsu 47, it was held that where a call for payment is made on the transferee of shares before his name is registered as a member, the call would be invalid and consequently the forfeiture of shares for non-payment of the call money would also be invalid.

73 *Bengal Electric Lamp Works Ltd, Re*, AIR 1942 Cal 516.

would be an illegal reduction of capital.[74] But the Supreme Court has now held in *Naresh Chandra Sanyal* v *Calcutta Stock Exchange Assn Ltd*[75] that "there is no provision in the Companies Act restricting the exercise of the right to non-payment of calls only".

> A stock broker, holding one fully paid share in the Exchange, carried on business on its premises. He had agreed to buy certain shares from a company, but failed to carry out his commitment. The shares were then resold by the company with the authority of the Exchange. The broker was required to pay the difference between the contract and resale prices. On his failure to do so his share was forfeited.

The Supreme Court held the forfeiture to be valid.[76] The Court said:

> [A] company may by its articles lawfully provide for grounds of forfeiture other than non-payment of a call, subject to the qualification that the articles relating to forfeiture do not offend against the general law of the land and in particular the Companies Act, and public policy; that the forfeiture contemplated does not entail or effect a reduction in capital or involve or amount to purchase by the company of its own shares, nor does it amount to trafficking in its own shares.

The learned judge then stated that the forfeiture of shares did not result in reduction of capital. The company was under an obligation to dispose of the forfeited share, and could not retain the same. Further, the reissue of a forfeited share was not an allotment, but only a sale, for otherwise the forfeiture, even for non-payment of call, would be invalid as involving an illegal reduction of capital.

Where the buses of a transport company were divided into two groups of shareholders, each group operating them separately, and one of them causing losses, that would not justify forfeiture of their shares.[77]

2. Notice precedent to forfeiture

A notice under the authority of the Board of directors must be served on the defaulting shareholder.[78] The notice should require him to pay the amount on a

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74 *See*, for example, *Hopkinson* v *Mortimer Harley & Co Ltd*, [1917] 1 Ch 646, where it was held that a forfeiture for debts due from a member generally as distinct from those due from him as a contributory, would amount to an illegal reduction of capital. This view has been accepted in Palmer's COMPANY LAW, 329 (20th Edn). But Calcutta High Court has held in *Naresh Chandra Sanyal* v *Ramani Kanto Roy*, AIR 1949 Cal 360: 49 CWN 503, that forfeiture is justifiable on any grounds provided for in the company's articles of association. *See* also *Kotah Transport Co* v *State of Rajasthan*, (1967) 37 Comp Cas 288 Raj, where forfeiture on irrelevant considerations was not allowed.

75 (1971) 1 SCC 50: (1971) 41 Comp Cas 51

76 For a criticism of this approach *see* K. Ponnuswami, *Forfeiture of Shares*, [1964] 1 Comp LJ 171. For a discussion of the whole of law of forfeiture *see* Srinivasan, *Forfeiture of Shares in Companies*, [1964] 1 Comp LJ 135.

77 *Dilbhajan Singh* v *New Samundri Transport Co (P) Ltd*, (1985) 58 Comp Cas 247 P&H. *See* also *K. Md. Farooq Ad* v *Portran Cirkit Electronics P Ltd*, (1997) 25 Corpt LA 209 (CLB), shares, which were fully paid, not allowed to be forfeited for the fact that the NRI holder had not obtained RBI approval. Seven years had passed and the allottee had already become a resident.

78 *Sulochana Nathany* v *Hindustan Malleables and Fongings Ltd*, (2002) 110 Comp Cas 874

day specified which should not be earlier than fourteen days from the date of service. The notice should clearly warn him that in the event of non-payment before the time fixed, the shares would be liable to be forfeited.[79] The notice must also specify the exact amount due from the shareholder. Where, for example, the notice of forfeiture claimed interest from the date of the call instead of the date fixed for its payment, it was held to be a bad notice and the forfeiture invalid.[80] "This seems to be somewhat technical. But in the matter of forfeiture of shares, technicalities must be strictly observed."[81] "A very little inaccuracy is as fatal as the greatest." It has been held by BACHAWAT J in a decision of the Supreme Court,[82] that a notice which does not specify the amount claimed by the company as call money, interest and expenses, is defective. "The defect in the notice, though slight, invalidates it and is fatal to the forfeiture."[83] In a case before the Delhi High Court,[84] shares were forfeited on the basis of a registered A D notice which came back as unserved, it was held that the forfeiture was bad, for it was the duty of the company to know whether the address of the member had changed. The fact that forfeited shares had been reallotted to others was held to be no defence and the member was entitled to have her name put back in the register for the same shares which she held before forfeiture. Even laches or delay on the part of the shareholder in protesting against the forfeiture was held to be not sufficient to disentitle her from her remedies.

3. Resolution of forfeiture

The above notice does not by itself operate as a forfeiture. The directors have further to pass a resolution declaring the forfeiture. Thus where the final resolution of forfeiture was not passed the court held[85] that, "a declared intention to forfeit not carried into effect is no forfeiture at all".[86] But the notice threatening forfeiture may incorporate the resolution of forfeiture as well. It may state that in the event of default the shares shall be deemed to have been forfeited. In such a case no further resolution is necessary.

CLB, notice of forfeiture was not given because the shares were held by a trust and the same should not have been entered in the register of members. The company had been dealing with the trust, issued bonus shares to it and paid dividends. Forfeiture ordered to be cancelled and the name of the trust restored with direction that shares be registered in the names of trustees.

79 *Satish Chandra Sanwalka* v *Tinplate Dealers Assn P Ltd*, (2001) 107 Comp Cas 98 CLB, a notice which does not specify that the failure to pay the call would result in the forfeiture being regarded invalid.

80 *Johnson* v *Lyttle's Iron Agency*, (1877) 5 Ch D 687: 36 LT 528.

81 Lord ROMER in *Premila Devi* v *People's Bank of Northern India*, ILR (1939) 20 Lah 1 PC.

82 *Public Passenger Service Ltd* v *Khadar*, [1965] 1 Comp LJ 1: AIR 1966 SC 489: (1966) 36 Comp Cas 1: [1966] 1 MLJ 23.

83 The case has been considered by K. Venkoba Rao, *Forfeiture of Shares*, [1966] 2 Comp LJ 89.

84 *Promila Bansal* v *Wearwell Cycle Co (India) Ltd*, (1978) 48 Comp Cas 202 Del.

85 *Prayam Prasad* v *Gaya Bank*, AIR 1931 Pat 44. *See also* the case of *Kanshi Ram* v *Kishore Chand*, AIR 1915 Lah 109: 29 IC 567.

86 Lord Lindley on COMPANIES, 738 (6th Edn), the learned author adds: "but if everything required to be done is substantially done by the company, and if the shares have been treated both by the company and the shareholder as forfeited, the shareholder will not be a contributory".

4. Good faith

Lastly, "the object of a power of forfeiture is that the company shall be enabled, for its own benefit, and adversely to the shareholder, to forfeit his shares if he fails to pay his calls. The power cannot be used at the request of the shareholder to relieve him of shares. The power must be exercised in good faith in the interest of the company."[87]

5. Right and liability after forfeiture

The liability of a member whose shares have been forfeited depends upon the provisions of the articles. The articles may provide that the member should be liable to pay all calls owing upon the shares at the time of the forfeiture. In such a case the members will remain liable as a debtor of the company, but not as a contributory,[88] even if the winding up follows more than one year after the forfeiture. He, however, remains a contributory as a past member for one year from the date of forfeiture.

His right is that when his shares are resold he can collect from the company the surplus of the sale proceeds after deducting the amount due. Thus the Supreme Court in *Naresh Chandra Sanyal* v *Calcutta Stock Exchange Assn Ltd*[89] declared that the articles of the Exchange which allowed it to retain such proceeds were invalid for two reasons: first, it would amount to penalty against the spirit of Section 74 of the Indian Contract Act; secondly, it would also be equivalent to a purchase by the company of its own shares in contravention of Section 77. The case is different from others, for forfeiture is generally carried out for non-payment of calls. Whereas, here, a fully paid share was forfeited. The grounds on which the court ordered refund of surplus may not apply to the case of a forfeiture for non-payment.

A person to whom forfeited shares have been reissued is governed by the terms of reissue. When the reissue is without any stipulation as to the outstanding calls, the new allottee cannot be held liable for the previous calls and interest on the overdue amount and his shares cannot be forfeited on that ground.[90]

Surrender of shares

Every surrender of shares, like forfeiture, amounts to reduction of capital.[91] But, while forfeiture is recognised by the Act, surrender is not. "There is no reference in the Act to surrender of shares; but these have been admitted by the courts, upon the principle, that they have practically the same effect as

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87 See *Esparto Trading Co, Re*, (1879) 12 Ch D 191.

88 *Ladies Dress Assn Ltd* v *Pulbrook*, [1900] 2 QB 376 CA. *See* further *Sri Gopal Jalan & Co* v *Calcutta Stock Exchange Assn*, AIR 1964 SC 250: 33 Comp Cas 862; *Calcutta Stock Exchange Assn* v *Nandy*, ILR (1950) Cal 235; *Naresh Chandra Sanyal* v *Ramani Kanto Roy*, AIR 1949 Cal 360: 49 CWN 503.

89 (1971) 1 SCC 50: (1971) 41 Comp Cas 51.

90 *Satish Chandra Sanwalka* v *Tinplate Dealers Assn P Ltd*, (2001) 107 Comp Cas 98 CLB.

91 COZENS-HARDY J in *Bellerby* v *Rowland & Marwood's Steamship Co*, [1902] 2 Ch 14, 32: [1900-03] All ER Rep Ext 1290.

forfeiture, the main difference being that one is a proceeding *in invitum* and the other a proceeding taken with the assent of the shareholder who is unable to retain and pay future calls on the shares."[92] Hence a company can only accept a surrender under conditions and limitations subject to which shares can be forfeited. A valid call and a default must exist and the directors may, instead of going to the length of forfeiture, in good faith accept a surrender from the shareholder. Surrender should not be used as a device for relieving a shareholder from his liability.[93]

REGISTER OF MEMBERS [S. 150]

Every company is bound to keep a register of shareholders, which should contain the following particulars: (1) The name and address of each member and his occupation; (2) The number of shares held by each member and the extent to which the shares have been paid up.[94] Each share should be distinguished by its appropriate number; the class of shareholders to which the member belongs should be indicated; (3) The date at which he was entered in the register as a member; and (4) The date at which any person ceased to be a member.[95]

The register may be in the form of a bound book or a computer record. Required particulars should be recorded and adequate precautions should be taken against tampering. Companies with more than fifty members are required to maintain an index of members.[96] The register itself may be kept in the form of an index or a separate card index may be used for the purpose. This is to enable entries relating to a particular member to be readily found. Any change in the register shall be noted on the index within fourteen days.

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92 See *Dronfield Silkstone Coal Co, Re*, (1880) 17 Ch D 76.

93 Following cases are illustrations of bad surrender of shares: *Collector of Moradabad* v *Equity Insurance Co*, AIR 1948 Oudh 197. In this case, after the death of a Raja who held several shares in a company, his shares were surrendered to the company and the surrender was accepted by the secretary of the company. It was held that "even if the secretary intended to accept the surrender, the transaction would be *ultra vires*. Under our law it is not open to a shareholder to surrender the shares held by him, or to the company to accept the surrender, unless the act of the company can be brought within the rules relating to forfeiture of shares". Yet another case is *Mangal Sain* v *Indian Merchants Bank, Amritsar*, AIR 1928 Lah 240. The objector having been placed in the list of contributories in the winding up of a company contended that he had surrendered his shares, and that the directors had, under a clear power in the articles of association, accepted the surrender. It was held that a company can only accept a surrender under conditions and limitations under which shares can be forfeited, which did not exist in the present case. See also *Mirza Ahamad Namazi, Re*, AIR 1924 Mad 703; *Bellerby* v *Rowland & Marwood's Steamship Co*, [1902] 2 Ch 14: [1900-03] All ER Rep Ext 1290. Where old shares are surrendered to get new ones of the same value, that is not a surrender, for it does not involve reduction of capital or of liability. *Rowell* v *John Rowell & Sons Ltd*, [1912] 2 Ch 609: 107 LT 374.

94 This means the amount which has been paid or agreed to be considered as paid on those shares. S. 150(1)(*b*).

95 S. 150(2) provides that the "company and every officer of the company who is in default, shall be punishable with fine which may extend to five hundred rupees for every day during which the default continues". Under S. 152 a similar register in respect of the same particulars has to be maintained for the company's debentureholders.

96 S. 151. Company and its officers are punishable for default with a fine extending up to five hundred rupees S. 152(4) for every day of default.

Register and index of beneficial owners [S. 152-A]

Where shares or debentures are held in the demat form, the register and index of beneficial owners maintained by a depository under S. 11 of the Depositories Act, 1996 is to be deemed as an index and register of members and that of debentureholders, as the case may be.

Foreign register of members [Ss. 157-158]

Where a company has issued shares or debentures to persons resident in another country, the company may, if so authorised by its articles, keep a branch register in that country. It will be known as a "foreign register". The Registrar of the company should be informed within 30 days of the situation of the office where the register is kept. If any change occurs in the situation of the register or when the register is discontinued, the Registrar should again be informed within 30 days.[97]

Section 158 supplements the provision by saying that the foreign register shall be a part of the company's home register which shall, in contrast to that, be called the principal register. In respect of closure, copies, extracts, inspection, etc., the foreign register is bound by the same provisions as apply to the principal register. An additional requirement, however, is that an advertisement for closure must also be published in a newspaper circulating in the district where the foreign register is maintained. Entries in the foreign register have to be transmitted to home office and a duplicate register has to be maintained in the home office. Entries in the foreign register should not be reflected in the principal register. But when the foreign register is discontinued, they may be shifted either to some other foreign register or to the principal register. For the rest of the matters, companies can frame their own rules.

Place of keeping, inspection and closure of register [S. 163]

The appropriate place for keeping the register is the registered office of the company.[98] Every member and a debentureholder has the right of inspection without fee but a prescribed fee can be charged from any outsider who wishes to inspect. This is to enable persons dealing with the company to ascertain for themselves the membership of the company. The company may, however, impose reasonable restrictions on the right of inspection, but the register must remain open for at least two business hours each day. The right to inspect also includes the right to make extracts from the register. The company is also bound

97 Sub-section (3) provides penalty for default in informing the Registrar in time.

98 The register may, of course, be kept at any other place within the same city, town or village in which the registered office is situate, provided a special resolution is passed to that effect and a copy of which has been given in advance to the Registrar and advertised for three consecutive days in a local daily. (S. 163).

to supply on demand a copy of the register.[1] Thus in *British India Corporation Ltd* v *Robert Menzies*:[2]

> A member applied for a copy of the register of members. The company received from him a fee of five hundred rupees, but put him off under pretexts of many kinds. On his application to the High Court, the latter ordered the company to supply a copy immediately. The court said: "It is a fundamental principle of legal administration that where the law requires something to be done there must be in existence a court that can directly order it to be done."

Now sub-section (6) of Section 163 has, in very clear words, given power to the Central Government to order the company to allow inspection and to give copies forthwith. The provision says that the Central Government may compel an immediate inspection of the document or supply of extracts.[3]

Where shares are in dematerialised form and the register of members is also in the magnetic form, only the stock holding corporation is shown as a member and not the individual beneficial holders of those shares. Such beneficial holders are not entitled to get a copy of the register. Their names are not there in the register at all.[4]

A company can close the register for 45 days in a year, but not for more than 30 days at any one time.[5] Seven days before the register is closed a notice must be published in a local daily.[6]

Register, prima facie evidence [S. 164]

The register of members is a *prima facie* evidence of the truth of its contents.[7] The contents of the register of members are of decisive importance in determining as to who were the shareholders of the company at the crucial time.[8] Accordingly, if a person's name, to his knowledge, is there in the register, he shall be deemed to be a member and onus lies on him to show that he is not a member.[9] Moreover, he must quickly apply to the court to take his name off the

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1 S. 163(3)(*b*) gives this right on the payment of a prescribed amount for every one hundred words or fractional parts thereof required to be copied. For right of debentureholders, *see Narotamdas T. Toprani* v *Bombay Dyeing & Mfg Co Ltd*, [1986] 3 Comp LJ 179 Bom.

2 AIR 1936 All 568: 1936 ALJ 748: 164 IC 387.

3 *Nutech Agro Ltd* v *Ch Mohan Rao*, (2002) 111 Comp Cas 75 AP, a complaint under the section was entertained for the company's failure to comply with the requirements even after the complainant had satisfied all the requirements for getting copies.

4 *HB Stockholdings Ltd* v *Jaiprakash Industries Ltd*, (2003) 116 Comp Cas 29 (CLB).

5 S. 154.

6 The word newspaper must be taken in its popular sense. Consequently, the Daily Official List of Stock Exchange is not a newspaper. *Talayar Tea Co* v *UOI*, [1990] 1 Comp LJ 360 Mad: (1991) 71 Comp Cas 95.

7 S. 164. This presumption, however, applies only to those contents which are required by the Act to be inserted therein.

8 *Ashish Das Gupta* v *Satvinder Singh*, (2000) 37 CLA 104 (CLB).

9 *See*, for example, *Amar Singh* v *Khalsa Bank Ltd*, AIR 1933 Lah 108; *Waryam Singh* v *Official Liquidator of Eastern Commercial & Banking Co Ltd*, AIR 1926 Lah 414; *Peninsular Life Assurance Co Ltd, Re*, AIR 1936 Bom 24; *Hans Raj Gupta* v *Asthana*, AIR 1932 PC 240.

register, failing which the doctrine of holding out comes into play. For example, in *M. F. R. D.'Cruz, Re*:[10]

> The plaintiff had applied for 4000 shares in a company. No allotment was, however, made. But, without his application, 4000 shares were transferred to him and his name placed in the register. The plaintiff, knowing that his name was in the register, took no steps to have it rectified. The company collapsed and it was held that his name was rightly placed in the list of contributories. The court said: "When a person knows that his name is included in the register of shareholders and stands by and allows his name to remain, he is holding out to the public that he is shareholder and thereby he loses his right to have his name removed."[11]

NO NOTICE OF TRUST [S. 153]

Sometimes shares of which *A* is the real owner may be had by him registered in the name of *B*. *A* is the beneficial owner and *B* is the trustee. In other words, *B* holds the shares in trust for *A*. Now, as the company's register of members will only show the name of *B*, therefore, for all purposes of company law, *B* alone is the member entitled to the rights and bound by the liability of membership. The company is not bound to recognise the existence of the trust, for, Section 153 declares in so many words that "no notice of any trust, express, implied or constructive, shall be entered on the register of members". A case from the Calcutta High Court provides a suitable illustration:[12]

> *S*, a lady, was the registered holder of certain shares in a company. The company, on learning that the shares really belonged to her husband, sued him for the unpaid calls on the shares. Holding that the husband was not liable, although he was the real owner, the court said: "Assuming that the registered shareholder is not the real owner but if he is the member in the books of the company, it is he alone who would be entitled to the rights of a shareholder and he alone is liable for share calls and to be put on the list of contributories."

But it is the beneficiary who is ultimately liable for the calls. He has to indemnify the trustee against calls and perhaps the company may directly sue him in the rights of the beneficiary.[13]

The company may, however, take notice of a trust for its own benefit without entering it in the register. In a Madras case:[14]

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10 AIR 1939 Mad 803: (1939) 2 MLJ 122.

11 There are many cases of this nature where a person had the right to have his name removed, but did not in time insist on it and, therefore suffered. *See* for example, *Peninsular Life Assurance Co Ltd, Re*, AIR 1936 Bom 24; *Mohd Akbar Abdulla Fazulbhoy* v *Official Liquidator*, AIR 1950 Bom 217: (1950) 20 Comp Cas 26; *Hans Raj Gupta* v *Asthana*, AIR 1932 PC 240; *Simpson* v *Molson's Bank*, 1895 AC 270, the company was not bound to take notice of the restrictions on transfer in a will under which shares were registered in the name of the present holder and a copy of the will was there with the company.

12 *Murshidabad Loan Office Ltd* v *Satish Chandra Chakarvarty*, AIR 1943 Cal 440: 209 IC 317.

13 *Hardoon* v *Belilios*, 1901 AC 118: 83 LT 573.

14 *S. Parameswari* v *K. M. R. Mills Ltd*, AIR 1971 Mad 293; [1970] 2 Comp LJ 120. Shares purchased by a firm of two partners were registered in the name of a minor. The liquidator of

A managing director's wife, having quarrelled with her husband and to teach him a lesson, brought an action for winding up. All the shares held by her were financed by her husband.

The court held that the company could take notice of this fact and present it to the court for the purpose of showing that her petition was not *bona fide* and was brought to exert pressure upon the managing director for settlement of the family dispute.

The articles of a company contained a clause that not more than a given percentage of shares were to be held by non-Bermudians. It was held that this clause was to apply only to registered shareholders and not to the beneficial owners of the shares. The registered holder was a Bermudian company. The provision was accordingly not violated whatever be the characteristic of shareholding in that member company.[15]

Certain bonds were purchased by a mutual fund. They were not allowed to be registered in the name of the trustee of the fund as S. 153 prohibits registration of any relationship of trustee and beneficiary in the register.[16]

Public trustee [Ss. 153-A, 153-B and 187-B]

The provisions of these sections have been deleted by the Amendment Act of 2000. The Amendment says that nothing contained in this section (in all the three sections) shall apply on or after the commencement of the amendment, i.e. Jan 14, 2001.

Declaration of beneficial interest [S. 187-C]

This section and Section 187-B have been deleted by the Companies (Amendment) Act, 2000. The new provision in Section 187-B says that the provisions of this section shall not apply on and after the commencement of the amendment, i.e. Jan 14, 2001. The new provision under Section 187-C says that the provisions of the section shall not apply to the trustee referred to in Section 187-B.

LIEN ON SHARES

"It is eminently fair for a company to provide by its articles, that the shareholders who are indebted to the company should not be permitted to dispose of their shares without paying their debts and that the company should have a lien on the shares for the debts."[17] Lien is the right to retain some property for some debt and in the case of a company, lien on a share ultimately means that the member would not be permitted to transfer his shares unless he pays his debt to the company. The right of lien is not inherent, but must be

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the company was not allowed to have the name of the minor substituted with those of the partners. The person on the register was liable whatever be his worth. *National Bank of Wales Ltd. Re*, (1907) 1 CR 582.

15 *Bermuda Cablevisions Ltd* v *Calico Trust Co Ltd*, [1998] 2 WLR 82.

16 *Canara Bank* v *NTPC*, (2001) 104 Comp Cas 97 SC.

17 ROMER LJ in *Allen* v *Gold Reefs of West Africa*, [1900] 1 Ch 656 at 678: [1900-03] All ER Rep 746.

clearly provided for in the articles. It is safer to adopt clauses 9 to 12 of Table A, which provide for this right.[18] The effect of lien on shares may be illustrated with the case of *Amar Nath* v *Karnal Electric Supply Co.*[19]

> A company had by its articles the first and paramount lien on the shares of each member for his debts to the company. The company was in liquidation and the plaintiff was a contributory. The liquidator was ordered by the Court to pay back half the value of each share to contributories, but he had not paid this amount to the plaintiff who brought an action to recover it. The liquidator contended that the company had a claim against him for which proceedings under Section 235[20] were pending and that he was withholding the payment in the exercise of the right of lien. He was held entitled to do so until the company's claim was settled. The mere fact that the claim was disputed could not suspend the lien for otherwise "any shareholder has only to dispute the liability and thereby to defeat the lien".

Postponement and loss of lien

A company's lien will, however, be postponed if the shareholder has mortgaged or pledged his shares before he has incurred any debt to the company and the company has notice of it. Thus where certain shares which were subject to a "first and paramount lien" were given to a bank as security for an overdraft and the bank had given notice to the company, it was held that the bank had priority over the company's claim which arose subsequently.[21] Notice obtained by the directors in the course of business will definitely amount to notice to the company. But if a director knows about the mortgage in his private capacity, will that operate as a notice to the company? The High Court of Allahabad has held that it would. The case is *U I Sugar Mills Co Ltd, Re*.[22]

> The liquidator of a company had a surplus and he proposed to divide it among the shareholders. The company had lien on shares. The managing director was indebted to the company for a large sum of money but he had mortgaged his shares before the commencement of winding up. Neither he nor the mortgagee had given notice to the company. As against the managing director the company was clearly entitled to exercise its lien on the amount payable to him. But the mortgagee claimed the amount on the ground that as the managing director had himself pledged the shares, his knowledge amounted to notice to the company. The court upheld this contention and said: "The company shall be deemed to have knowledge of such transaction when the managing director who has all powers of the board has himself pledged his shares, although in his private capacity."

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18 Lien is governed strictly by the provisions of the Companies Act and the company's articles and not by those of the Contract Act relating to pledge of goods. *Khadija* v *P. K. Md. (P) Ltd.* (1985) 58 Comp Cas 543.

19 AIR 1952 Punj 411.

20 Act of 1913, which provided for proceedings against delinquent officers of the company.

21 *Bradford Banking Co* v *Briggs, Son & Co*, (1886) 12 App Cas 29: 56 LT 62.

22 AIR 1933 All 607: 1933 ALJ 1322: 146 IC 801.

The decision amounts to this that knowledge obtained by a managing director in the course of a private transaction of his own amounts to notice to the company. The only case cited as an authority in support of this view is ***Rainford*** v ***James Keith & Blackman Co Ltd***,[23] but in this case the facts were entirely different. A shareholder who was also a servant of the company had informed the directors that his shares were with someone else from which, the court said, the directors should have inferred that they must have been pledged. Even according to the ordinary principles of the law of agency notice to an agent is not deemed to be notice to the principal if the agent fraudulently withholds it from his principal.[24]

Where the holder of shares is a trustee, the company's lien will prevail over the claim of the beneficiary unless he has given notice to the company before any occasion arose for enforcing the lien.[25] A company's claim against the beneficial owner of shares cannot entitle the company to exercise the right of lien against the trustee-holder of those shares.[26] Where the right to exercise the lien has arisen and the shareholder transfers a part of his shares, the transferee can insist that the company should satisfy its claim to the extent possible from the shares remaining in the hands of the shareholder.[27] Lien remains effective even after the death of the shareholder and can be exercised against his executors.[28]

Sale of shares under lien

In order to realise the money due to it the company may take the power to sell the shares held under lien. The transferee of such shares will get a good title even if there has been some irregularity in the procedure of transfer as it will be covered by the principle of indoor management.[29]

The present position of a listed public company being that it can no longer reject a transfer on any ground whatsoever, its lien may also become defeated under the doctrine of absolutely free transferability. In this case, the shares held by the managing director were transferred by his legal heirs after his death. The company was directed to accept the transfer and also to pay the amount of dividend which it had withheld under its lien for claims against the managing director.[30]

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23 [1905] 2 Ch 147.

24 *See* S. 229, Indian Contract Act, 1872 and a commentary on it by Avtar Singh, LAW OF CONTRACT.

25 *New London & Brazilian Bank* v *Brockle Bank*, (1882) 21 Ch D 302; *Mackereth* v *Wigan Coal Co*, [1916] 2 Ch 293.

26 *Perkins, Re*, (1890) 24 QBD 613 CA.

27 *Gray* v *Stone*, (1893) 69 LT 282.

28 *Allen* v *Gold Reefs of West Africa*, [1900] 1 Ch 656: [1900-03] All ER Rep 746.

29 *Unity Co (P) Ltd* v *Diamond Sugar Mills*, [1970] 2 Comp LJ 64 Cal.

30 *Ferrom Electronics (P) Ltd* v *Vijaya Leasing Ltd*, (2000) 36 CLA 327 Kant.

Time-barred debt

Lien on shares may be exercised even for a time-barred debt, provided that it can be done without resort to a court of law.[31]

ANNUAL RETURNS [Ss. 159-161]

Every company has to file with the Registrar an annual return containing certain particulars. This is to enable the Registrar to record the changes that have occurred in the constitution of the company during the year. Separate kinds of returns are required from companies, those with share capital and those having no share capital. The return of a company having share capital has to contain the particulars specified in Part I of Schedule V regarding—[32]

(*a*) its registered office,

(*b*) its register of members,

(*c*) the register of its debentureholders,

(*d*) its shares and debentures,

(*e*) its indebtedness,

(*f*) its members and debentureholders, past and present, and

(*g*) its directors, managing directors, managers and secretaries, past and present.

The return of a company having no share capital has to state the following particulars:[33]

(*a*) the address of the registered office of the company;

(*b*) the names of members and the respective dates on which they became members and the names of persons who ceased to be members since the date of the annual general meeting of the immediately preceding year, and the dates on which they so ceased;

(*c*) all such particulars with respect to the persons who, at the date of the return, were the directors of the company, its manager and its secretary as are set out in Section 303;

(*d*) a statement containing the particulars of the total amount of the indebtedness of the company in respect of all charges which are or were required to be registered with the Registrar under the Act.[34]

Where any of the five preceding returns has given the particulars, then the return may only give such of the particulars as relate to persons ceasing to be or becoming members or shares transferred or changes in the holding of a particular member.

The return has to be filed within sixty days from the date of the annual general meeting.[35] It must be signed both by a director and by the manager or

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31 *Ferrom Electronics (P) Ltd* v *Vijaya Leasing Ltd*, (2000) 36 CLA 327 Kant.

32 S. 159(1). The format of Sch V has been changed to a certain extent, *vide* GSR 389(E), 15-5-95, *see* Chartered Secy, June 1995, p 551.

33 S. 160(1).

34 S. 160(2).

35 S. 159(1).

secretary of the company, if any, otherwise, by two directors of the company, one of whom shall be the managing director where there is one.[36] The return of a company whose shares are quoted at a stock exchange must also be signed by a secretary in wholetime practice.[37] The return must accompany a certificate signed likewise stating that the return states the facts as they stood on the day of the annual general meeting and that since the date of the last annual return the transfer of all shares and debentures and the issue of all further certificates of shares and debentures have been appropriately recorded in the books maintained for the purpose.[38] In the case of a private company, the certificate must further state that the company has not during the year issued any invitation to the public to subscribe for shares or debentures of the company[39] or for deposits and that its annual turnover has not crossed the prescribed limit.

Although sixty days are reckoned from the date of the annual meeting, it has been held by the Supreme Court in *State of Bombay* v *Bandhan Ram Bhandani*[40] that the obligation to file returns is not excused by any default in calling the meeting, for they can be prepared independently of the annual meeting.[41] The penalty is imposed upon "every officer in default", which according to Section 5 means a person who is knowingly guilty of the default or who knowingly or wilfully permits or authorises such default. Kerala High Court did not allow this penalty to be imposed upon an officer merely on the ground that he should have known that no return was filed from the fact that he did not sign any. It could as well have been signed by others.[42]

Nature of offence, whether continuing

There is a conflict of views between the High Courts as to whether offences punishable under this Section are of a continuing nature. Failure to file the

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36 S. 161(1).

37 A secretary can sign the returns of up to 30 companies. Notification ICSI No. 2 of Aug 2, 1989; 1989 Chartered Secy 701.

38 S. 161(2).

39 S. 161(2) and (6). *See also* S. 162 which contains provisions about penalty and interpretation.

40 (1961) 1 SCR 801: AIR 1961 SC 186: (1961) 31 Comp Cas 1.

41 Reaffirmed in *State of HP* v *AP Potteries Ltd*, (1973) 2 SCC 786: (1973) 43 Comp Cas 514.

42 *V. M. Thomas* v *ROC*, (1980) 50 Comp Cas 247 Ker. The Calcutta High Court has held that the default is a single offence and not a continuing offence. Prosecution must be commenced within six months from the date of default otherwise it becomes time-barred. *Nripendra Kumar Ghosh* v *ROC*, (1985) 58 Comp Cas 672 Cal, overruling its earlier decision in *Ajit Kumar Sarkar* v *Asstt ROC*, (1979) 49 Comp Cas 909: 83 Cal W N 108 and following *National Cotton Mills* v *Asstt. ROC*, (1983) Cal HN 180: (1984) 56 Comp Cas 222. The plea of time-bar should be raised at the trial stage. *Sanjeev Kumar Gupta* v *ROC*, [1990] 2 Comp LJ 70 Del; Members and debenture-holders are entitled to free inspection and Re 1 for 100 words copy; others, Rs 10. Rule 21-A of the Companies (Central Govt's) Rules and Forms, 1956. A director who was not connected with the default, not allowed to be prosecuted, *Registrar of Companies* v *Bipin Bihari Nayak*, (1996) 86 Comp Cas 641 Ori; prosecution quashed where the director in question had ceased to be so on the due date of the return, *Jayesh R. Mor* v *State of Gujarat*, [2000] CLC 486 (Guj). *K. Setha Lakshmi* v *ROC*, (2001) 103 Comp Cas 532 Mad, on the demise of the accused director his wife was allowed to be impleaded because she was also a director in her right and was also in a position of being in charge.

annual return has been held not to be a continuing offence in some cases. The opposite view has been taken in this case.[43]

Evidentiary value

Where the holding of a given percentage of shares is a requisite qualification for exercising certain rights under the Companies Act, entries in the annual returns can serve as evidence for the purpose.[44]

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43 *Asstt Registrar of Companies* v *Premier Synthetics (P) Ltd*, (1997) 89 Comp Cas 732: (1997) 26 CLA 269 (Mad). One serious implication of a continuing offence is that the provisions of Sections 467 to 473 of CrPC relating to periods of limitation for starting proceedings do not apply. S. 472 of the Code says that in the case of continuing offence, a fresh period of limitation begins to run at every moment of the time during which the offence continues. *Pravin Jha* v *State of AP*, (2001) 106 Comp Cas 554 All, not a continuing offence, cognizance has to be taken within 6 months from the date of the offence, S. 468, CrPC.

44 *Rashmi Seth* v *Chemon India (P) Ltd*, [1992] 3 Comp LJ 89 CLB: (1995) 82 Comp Cas 563, the petition here was for prevention of oppression and mismanagement.

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Share Capital

Share capital is not a necessary condition of incorporation, although greater number of companies are registered with it than without it. In case share capital is thought necessary, the memorandum must state the amount of capital with which the company is desired to be registered and the number of shares into which it is to be divided.[1] The meaning of "share capital" was explained by the Kerala High Court in *S. N. D. P. Yogam, Quilon, Re*:[2]

> An application was presented under Section 397 against "Yogam" and the question was whether the company was with or without share capital. According to the memorandum the liability of the members was limited; each member was required to take at least one share, but no authorised capital was mentioned.

The court quoted from Buckley on THE COMPANIES ACTS[3] and from Palmer's COMPANY LAW to find support for the proposition that the words "capital" and "share capital" are synonymous. For a company to have share capital it is necessary that its memorandum should state the amount and its division. Thus share capital is different from membership fee, even if the payment is symbolised by the issue of a share.

The amount stated in the memorandum becomes the *authorised capital* of the company. The whole or any part of it may be issued. Supposing that only half of it is issued, then that is the *issued capital* of the company. If the offer of issue is made to the public the whole of it may not be taken up. That part of the issued capital which has been allotted is the *subscribed capital.* The company need not immediately call up the whole amount. The actual amount received is the *paid-up capital.*

The uncalled capital of a company can be converted into *reserve capital.* By passing a special resolution the company may declare that a portion or whole of its uncalled capital shall not be called except in the event of the company's winding up.[4] Such a capital cannot be called except in winding up; it cannot be converted except with the leave of the court; it cannot be charged by the directors. Thus, where a company issued debentures charging its undertaking including the uncalled capital, it was held that the charge was not operative on the reserve capital.[5]

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1 S. 13(4). Section 82 says that the share or other interest of a member in the company shall be movable property transferable in the manner provided in the company's articles.

2 (1970) 40 Comp Cas 60: ILR 1969 Ker 516: [1970] 1 Comp LJ 85.

3 154 (13th Edn).

4 S. 98 gives the power to an unlimited company on getting itself registered as a limited company to increase the nominal amount of its share capital by increasing the nominal value of shares provided that the increased amount shall not be called up except for the purposes of winding up. The company can provide that a specified portion of its uncalled capital shall not be capable of being called up except on winding up.

5 *Mayfair Property Ltd, Re*, [1898] 2 Ch 28: [1895-99] All ER Rep 738.

KINDS OF SHARE CAPITAL

Capital must be divided into shares of a fixed amount. All the shares may be of only one class or may be divided into two different classes of securities. For this purpose securities means securities defined in Section 2(*h*) of the Securities Contracts (Regulation) Act, 1956 and includes "hybrids".[6] The Act permitted only two kinds of shares to be issued, namely: [7]

1. Equity share capital, that is, ordinary shares, and
2. Preference shares, which constitute the preference share capital.

Ordinary share capital or 'equity share capital' is defined in the Act as meaning all share capital which is not preference share capital.[8]

The Companies (Amendment) Act, 2000, has substituted Section 86 with new provisions which are that 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 (*ii*) with differential rights as to dividend, voting or otherwise in accordance with such rules and subject to such conditions as may be prescribed. (*b*) preference share capital.

The Companies Amendment Act, 2000 has introduced some other categories of shares:

Derivative

Which has been given the same meaning as in Section 2 of the Securities Contracts (Regulation) Act, 1956.

Hybrid

As defined in Section 2(19-A), it means any security which has the characteristics of more than one type of security, including their derivatives.

Preference share capital [S. 85]

Preference share capital means that part of the share capital of a company which fulfils both the following requirements:[9]

1. During the continuance of the company it must be assured of a preferential dividend. The preferential dividend may consist of a fixed amount (say fifty thousand rupees in one year) payable to preference shareholders before anything is paid to the ordinary shareholders, or the amount payable as preferential dividend may be calculated at a fixed rate, for example, 5 per cent of the nominal value of each share.

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6 S. 2(45-AA) introduced by the Amendment Act, 2000 (w.e.f. 14-1-2001).

7 S. 86. Each share shall be distinguished by its appropriate number. S. 83. Private companies are exempted and, therefore, they enjoy the freedom of having any other kinds also.

8 S. 85(2).

9 *Id.*, sub-section (1). It is not necessary to give any priority to the amount of dividend remaining unpaid up to the commencement of winding up or to any fixed premium or premium on any fixed scale specified in the memorandum or articles of the company. [S. 85(1)(*b*)(*i*) and (*ii*)]

2. On the winding up of the company it must carry a preferential right to be paid, that is, the amount paid up on preference shares must be paid back before anything is paid to the ordinary shareholders. This preference, unless there is an agreement to the contrary, exists only up to amount paid up or deemed to have been paid up on the shares.

Cumulative and non-cumulative preference shares

Preference shares may be either *cumulative* or *non-cumulative*. If there are no profits in one year and the arrears of dividends are to be carried forward and paid out of the profits of subsequent years, the preference shares are said to be cumulative. But if unpaid dividend lapses, the shares are said to be non-cumulative preference shares. Whether they are of one class or the other will depend upon the terms of issue and provisions in the company's articles. But, in the absence of any clear provision to the contrary, preference shares are presumed to be cumulative. *Foster* v *Coles, Foster & Sons Ltd*[10] is an authority:

> A company whose memorandum and articles provided for preference shares carrying a "cumulative preferential dividend" was reconstructed and clause 95 of the articles was altered by striking out the word "cumulative" before "preference" so as to read thus: "The net profits from time to time available for distribution as dividend shall be applied first in payment to holders of preference shares of a preference dividend." Even so it was held that the holders of preference shares were entitled to a cumulative preferential dividend. The word "cumulative" was dropped obviously with the intention of converting the preference shares into non-cumulative shares. But unless there was a clear provision in the articles to that effect they were presumed to be cumulative preference shares.

Thus preference shares are always presumed to be cumulative and the accumulation of dividend can be excluded only by a clear provision in the articles of association. As, for example, in *Staples* v *Eastman Photographic Materials Co*:[11]

> The provision in the articles of association of a company was like this: "The holders of preference shares shall be entitled out of the net profits of each year to a preference dividend at the rate of 10 per cent per annum." It was held that according to this provision, preference shareholders were not entitled to a cumulative dividend of 10 per cent so as to have the deficiency in one year paid out of the profits of a subsequent year. The provision meant that the profits of each year only were to be paid in that way.

Preference shareholders cannot compel the directors to pay dividends, whatever be the amount of accumulation.[12]

Participating preference shares

There is yet another problem concerning preference shares. After the fixed amount of dividend has been paid to the preference shareholders and some

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10 (1906) 22 TLR 555.

11 [1896] 2 Ch 303. *See* also *Webb* v *Earle*, (1875) LR 20 Eq 556: 44 LJ Ch 608.

12 *Buenos Aires Great Southern Rly Co* v *Preston*, [1947] Ch 384: [1947] 1 All ER 729.

amount has by way of dividend been paid to the ordinary shareholders, there may be surplus profits which are proposed to be distributed among the shareholders. The question is whether the preference shareholders are also entitled to take part in the distribution of the surplus. Again, in the winding up of a company, if, after paying back both the preference and ordinary shareholders, there is a surplus, the question will be whether preference shareholders are also entitled to a share in the distribution of the surplus. If they are so entitled they will be known as *participating preference shares*.[13]

The general principle is that preference shares are presumed to be not participating. The holders of such shares are not entitled to any share in the distribution of any such surplus, unless there is a clear provision in the memorandum, or the terms of issue or the articles conferring upon them the right of participation. This appears from a consideration of the authorities. Reference may be made here to one of them, namely, *Will* v *United Lanket Plantations Co Ltd*:[14]

> Preference shareholders were entitled to a cumulative preference dividend at the rate of 10 per cent per annum and, it was further provided in the company's articles, that such preference shares ranked both as regards capital and dividend in priority to other shares. It was held that preference shareholders were not entitled in the distribution of the profits to anything more than 10 per cent dividend.

Accordingly, to find out the rights of a special class of shareholders we must look within the four corners of the articles of association of the company and the terms of the issue. If the right to participate in the surplus is not specified in the terms of the issue, preference shares are presumed to be not participating. This was affirmed by the House of Lords in *Scottish Insurance Corpn* v *Wilsons & Clyde Coal Co*:[15]

> A company intended to go into voluntary liquidation. Meanwhile it proposed to reduce its capital by returning their capital to the holders of the preference stock. Under the articles of the company, in the event of winding up, preference stock ranked before the ordinary to the extent of the amount paid thereon. The reduction of capital was opposed by certain preference stockholders on the ground that it deprived them of the right to participate in the liquidation and the division of the company's surplus assets. Thus the question was whether the preference stockholders would be entitled in winding up to a share in the surplus assets or, in other words, to receive more than a return of their paid up capital.

Lord SIMONDS said:

> "It is clear from the authorities that subject to any relevant provisions of the general law, the rights *inter se* of the preference and ordinary shareholders must depend on the terms of the instrument which contains the bargain that they have made with the company and each other."

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13 S. 85(1) *Explanation*.
14 [1912] 2 Ch 571: 1914 AC 11: 107 LT 360.
15 1949 AC 462.

It means that their right to participate in the surplus depends upon the terms of the contract they have made with the company and there is no presumption that they have the right to participate unless it is excluded by the articles. There was nothing in the articles giving them the right to receive anything beyond the amount paid on their shares.

Then again the mere fact that under a company's articles preference shareholders are entitled to participate with the ordinary shareholders in the surplus profits does not entitle them in the company's winding up to participate in the surplus assets also. This was the position taken in *Isle of Thanet Electricity Supply Co, Re*:[16]

> A clause in the articles of association of a company defined the rights of shareholders as follows: "The issued preference shares shall confer on the holders the right to a fixed cumulative dividend at the rate of 6 per cent per annum in priority to the ordinary shares and the right to participate *pari passu* with the ordinary shares in the surplus profits which in respect of any year it shall be determined to distribute.... and the preference shares shall confer the right in a winding up of the company to repayment of capital, together with arrears, if any." The company went into voluntary liquidation. Certain arrears of dividend on the preference stock were paid and the capital on both the preference and ordinary stock was repaid. As regards the surplus, it was held that the onus lay on the preference stockholders to show that they were entitled to participate therein; the above provision in the articles must be taken as being exhaustive in defining their rights and, therefore, the onus had not been discharged.[17]

Issue and redemption of preference shares [S. 80]

A company has the power under Section 80 to issue what are known as redeemable preference shares. There must, however be an authority to issue such shares in the articles of the company. The option of redemption lies with the company, that is to say, the company may choose to pay back the holders of such shares. Paying back is called redemption. There are following restrictions in regard to the fund out of which shares can be redeemed.[18]

Firstly, the shares to be redeemed must be fully paid.

Secondly, shares shall be redeemed only out of profits of the company which would otherwise be available for dividends. The only other method allowed by the Act is to make a fresh issue of shares and utilise the proceeds to carry out the redemption. Again, if any premium is payable on redemption, the amount must have been provided for out of the profits of the company or out of the company's Securities[19] Premium Account.

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16 [1949] 2 All ER 1060: [1950] Ch 161; *W Foster & Sons Ltd, Re*, [1942] 1 All ER 314.

17 For other cases see *Chatterley-Whitfield Collieries Ltd, Re*, [1948] 2 All ER 593 CA and *Prudential Assurance Co Ltd* v *Chatterley etc.*, 1949 AC 512: [1949] 1 All ER 1094.

18 S. 80(1) proviso.

19 *Substituted* for "shares" by the Companies (Amendment) Act, 1999, w.e.f. from Oct 31, 1999.

Lastly, where redemption is made out of profits, a sum equivalent to the amount paid on redemption shall be transferred to a reserve fund to be called, *Capital Redemption Reserve Account.* This amount is to be preserved with the same sanctity as the company's share capital and can be reduced only in the like manner.[20] Redemption of preference shares is not taken as reduction of the company's authorised share capital.[21] The company may issue new shares up to the nominal amount of the shares redeemed and the capital shall not be deemed to have been increased.

The capital redemption reserve account may be applied in paying up unissued shares of the company to be issued to the members as fully paid bonus shares.[22]

Irredeemable Preference Shares

The amendment of 1988 abolished the category of irredeemable preference shares. Sub-section (5-A), inserted by the amendment, says that no company limited by shares shall issue any preference share which is irredeemable or is redeemable after the expiry of a period of 10 [now 20 years, amendment of 1996] years from the date of issue.[23]

Ordinary shares compared with preference shares

Preference shares, particularly redeemable preference shares, are more like debentures than like shares. They are entitled to a fixed rate of dividend even as

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20 S. 80(1)(*d*).

21 S. 80(3).

22 S. 80(5). *See also* sub-section (6) which contains penalty provisions.

23 A new section, S. 80-A, was inserted to provide about the redemption of existing irredeemable preference shares. They must be redeemed within 5 years from the effective date of the amendment. Shares which are redeemable within ten years will be redeemed as they fall due, but the period should not be more than ten [now 20 years, amendment of 1996] years. If a company is not able to do so, it should make a petition to the Company Law Board (now Tribunal). The Board may permit their renewal under a ten-year scheme and then they shall be deemed to have been redeemed. These provisions as to compulsory redemption have been declared to be beyond the reach of any provision of S. 106 or any scheme under Ss. 391 to 395 or S. 396. They cannot be varied by any resolution at a class meeting or by the court or the Central Government. Failure to comply with the provision involves a punishment for the company which may extend to Rs 1000 for every day of default and for its officers who are in default an imprisonment extending upto 3 years and also a fine. The amendment has been enforced w.e.f. 15-1-1988, GSR 559(E) of 10-6-1988. A company which does not carry out a redemption as required by the new provision is restrained from paying dividends up to the time of implementation. In quite a few cases the Company Law Board permitted renewal alongwith accumulated dividend amount. See *Kalyanpur Cements Ltd, Re*, [1993] 3 Comp LJ 109 CLB Cal; *British India Corpn Ltd, Re*, [1993] 3 Comp LJ 445 CLB; *Mangalore Chemicals Ltd, Re*, [1994] 1 Comp LJ 306 CLB; (1994) 79 Comp Cas 551; *Calendonian Jute & Industries Ltd, Re*, (1995) 18 Corpt LA 44; (1996) 85 Comp Cas 180, allotment of new shares to carry arrears of dividend whether due, declared or not. *Auckland Holdings Ltd, Re*, (1995) 17 Corpt LA 154 CLB, the Board did not permit postponement of redemption on grounds like difficulty of liquidity, particularly in view of the fact that the company had reserves and also current profits to meet the costs of redemption. *Rishi Gases (P) Ltd, Re*, (1995) 83 Comp Cas 589 CLB, arrears of dividended, whether declared or not, ordered to be included in the value of the shares to be issued in lieu of redemption. *Jessop & Co Ltd. Re*, (2000) 27 SCL 82 CLB, the CLB does not have the power to extend the period for redemption. *Raja Ram Corn Products (Punjab) Ltd* v *CLB*, (2003) 113 Comp Cas 33 P&H, the CLB could prescribe the rate of dividend to be attached to new shares.

debentures earn a fixed rate of interest. The company may choose to pay them back,[24] but ordinary shareholders cannot be paid back except under a scheme involving reduction of capital.[25]

Secondly, an ordinary shareholder is entitled to vote on all matters affecting the company. But the right of a preference shareholder to vote is restricted to resolutions which directly affect the rights attached to his preference shares, except when dividend has remained unpaid in which case he may vote on any resolution in respect of preference share capital.[26]

Thirdly, preference shares offer a profitable and safe source of investment. While the fixed rate of income is guaranteed, the risk involved is much less as compared to the risk undertaken by an ordinary shareholder.

Alteration of capital [S. 94]

A limited company with a share capital can alter the capital clause of its memorandum of association in any of the following ways, provided authority to alter is given by the articles:[27]

(*a*) It may increase its capital by issuing new shares.[28]

(*b*) Consolidate the whole or any part of its share capital into shares of larger amount.

(*c*) Convert shares into stock or *vice versa.*

(*d*) Sub-divide the whole or any part of its share capital into shares of smaller amount.

(*e*) Cancel those shares which have not been taken up and reduce its capital accordingly.

Any of the above things can be done by the company by passing a resolution at a general meeting, but do not require to be confirmed by the National Company Law Tribunal.[29] Within thirty days of alteration notice must be given to the Registrar who will record the same and make necessary alteration in the company's memorandum and articles.[30] Notice to the Registrar has

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24 S. 80. This, however, does not mean that the holder of redeemable preference shares can treat himself like a creditor if his shares are not redeemed in time on maturity and take the liberty of filing a creditor's petition for an order of winding up. *Lalchand Surana* v *Hyderabad Vanspati Ltd*, (1990) 69 Comp Cas 415 AP.

25 S. 100.

26 S. 87(2) (Explanation) and clause *(b)*.

27 S. 94(1). Cancellation of shares under clause (*e*) does not amount to reduction of capital for the purposes of the Act [S. 94(3)]. Section 96 provides that where a company having a share capital has converted any shares into stock and notified the Registrar, the provisions of the Act relating to shares shall cease to apply.

28 *Nupur Mitra* v *Basubani P Ltd*, (2002) 108 Comp Cas 359 (CLB), increase of capital beyond the authorised limit set in the memorandum is *ultra vires*. The capital clause of the memorandum would have to be altered for that purpose.

29 S. 94(2). The section requires only an ordinary resolution for increase of capital. *Janaki Printing (P) Ltd* v *Nadar Press Ltd*, [2000] 3 Comp LJ 283 (CLB).

30 S. 95. *See also* sub-section (3) which imposes penalty for default. The default is a continuing offence. Subsequent replacement of the original resolution which remained unnotified did not wipe out the offence, *Amison Foods Ltd* v *ROC*, [1999] 1 Comp LJ 115 Ker. Another ruling to the same effect is *Amison Foods Ltd* v *ROC*, (2001) 103 Comp Cas 846 Ker.

similarly to be given when redeemable preference shares have been redeemed.[31] Similar information is also required to be sent where the capital has been increased beyond the authorised limit, or where a company, being not limited by shares, has increased the number of its members.[32]

REDUCTION OF CAPITAL

A reduction of capital is unlawful except when sanctioned by the court (now Tribunal).[33] "Conservation of capital is one of the main principles of company law." The share capital of a company is the only security on which the creditors rely. Any reduction of capital, therefore, diminishes the fund out of which they are to be paid. It is for this reason that companies limited by shares are not allowed to purchase their own shares, because the capital is thereby reduced.[34] For the same reason, the power to forfeit, and to accept a surrender of, shares is strictly guarded.[35] But sometimes there may be a genuine necessity for the reduction of capital. Closely fenced power is, therefore, given by Section 100. Under this section a company limited by shares or a guarantee company having a share capital may reduce its capital in any way. It may, for example:

1. extinguish or reduce the liability on any of its shares;
2. cancel any paid-up share capital which is lost or is unrepresented by any available assets;[36]
3. pay off any paid-up share capital which is in excess of the wants of the company.[37]

Complete details of the procedure to be followed for effecting a reduction are given in the Act itself. Authority to reduce capital must be present in the articles. In pursuance of that authority a special resolution must be passed which should authorise the contemplated reduction of capital.[38] The next stage is to

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31 S. 95(1)(*e*).

32 S. 97. *See* sub-section (3) which imposes penalty for default. See also *Mahalaxmi Mills Co* v *State*, [1970] 1 Comp LJ 80 Raj.

33 S. 100.

34 S. 77.

35 See *Forfeiture of Shares*, Chapter 8, above. Where rights issue meant for employees was allotted under misrepresentation to employees' relatives, the company was permitted to rectify the register of members by substituting the names of employees but not to cancel them because that would have amounted to reduction of capital. *Polar Latex Ltd* v *Lakshmi Narayan*, (1995) 18 Corpt LA 7 CLB. Some other provisions founded on the requirement of maintaining the capital are, a subsidiary cannot purchase shares in its holding company, [S. 42]; dividends are not allowed to be paid out of capital, [S. 205]; in England, under EC directives a meriting of members has to be called when the company has lost half or more than half of its share capital.

36 See *Vantech Industry Ltd, Re*, [1999] 2 Comp LJ 47, a company allowed to cancel capital in respect of shares which were allotted to public but which remained unpaid.

37 S. 100(1). For a statement of the ways in which the need for reduction may arise, see *Indian National Press (Indore) Ltd, Re*, (1989) 66 Comp Cas 387, 392 MP. Where a scheme of amalgamation under Ss. 391 to 395 involves reduction of capital, the procedure prescribed for such reduction has to be followed. *Asian Investments Ltd, Re*, (1993) 73 Comp Cas 517 Mad; *Durairajan* v *Waterfall Estates Ltd*, (1972) 42 Comp Cas 563 Mad.

38 There should be a valid meeting and a valid resolution. See *Jaiton Stock Exchange Assn. Ltd, Re*, AIR 1952 Pepsu 114. In *Barry Artist Ltd, Re*, (1985) BCLC 283, the court allowed reduction on the basis of a resolution signed by all the members without a formal meeting. The court, however, issued this warning that the practice should not be repeated.

apply, by petition, to the National Company Law Tribunal for an order confirming the reduction.[39]

Duties of Tribunal

The Tribunal is burdened with onerous duties. The basic function of the court, however, is to look after the interest of the creditors and different classes of shareholders.

Interest of creditors.—Creditors are likely to be hit only when the reduction diminishes the liability of shareholders to pay the uncalled capital or where the proposed reduction involves payment to any shareholders of any paid-up share capital.[40] In other cases creditors are not entitled to object. Again only such creditors are entitled to object to whom the company owes a debt which would have been provable in the winding up of the company.[41] Of such creditors who are entitled to object the court must settle a list. Should all the creditors not consent to the reduction, the court may dispense with the consent of dissentient creditors provided that their debts are secured to the satisfaction of the court. The court has also been given the discretionary power of dispensing altogether with the consent of creditors, but this the court will do only when it is convinced that they are not in any way affected.[42] In one of the cases on the subject,[43] a company had issued shares and debentures in equal amount. It lost the bigger part of its capital. A part of the lost capital was recouped out of subsequent profits. The rest was proposed to be written off. The debenture holders were not allowed to raise any objection. Their position remained the same whether with or without reduction. Where certain creditors objected but the company secured their dues and also complied with the direction of the court (now Tribunal) to keep an amount in fixed deposit in the name of the Registrar of the court, the reduction was confirmed.[44]

Interest of shareholders.—The second duty of the court (now Tribunal) is to look after the interest of the shareholders. The proposed scheme of reduction must

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39 S. 101. Where shares were allotted to a lender by mistake and he claimed back his money, it was held that even in such a case the formalities of reduction should be met. *Rupak Ltd* v *ROC*, (1976) 46 Comp Cas 53 Pat.

40 S. 101(2). Officers of the company concealing the names of creditors are made punishable under S. 105.

41 S. 101(2)(*a*).

42 S. 101(2), clauses (*a*), (*b*) and (*c*) and sub-section (3). *See*, for example, *Lucania Temperance Billiard Halls (London) Ltd, Re*, [1965] 3 All ER 879: [1966] 1 Comp LJ 350: [1966] Ch 98: [1966] 2 WLR 5. Another case in which creditors are not likely to be affected is where a company had to rectify its register of members by removing the names of members of its own parent companies to whom shares had been allotted in violation of the Exchange Control Act, 1947, (English). See *Transatlantic Life Assurance Co Ltd, Re*, [1979] 3 All ER 352.

43 *Meux's Brewery Co Ltd, Re*, [1919] 1 Ch 28: [1918-19] All ER Rep 1192.

44 *OCL (India) Ltd, Re*, AIR 1998 Ori 153. The court considered *Meux's Brewery Co Ltd, Re*, (1919) 1 Ch 28: [1918-19] All ER Rep 1192 where the debentureholders 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 to show that the lost capital was attributable to circulating capital. *Wesburnt Sugar Refineries Ltd, Re*, [1951] 1 All ER 881, paying off capital can be done otherwise than by payment of money.

be reasonable and fair between all the classes of shareholders in the company. If the capital of a company consists of only one class of shares and all of them are to bear the reduction proportionately the scheme is obviously fair and must be confirmed. And so in *Marwari Stores Ltd* v *Gouri Shanker Goenka*:[45]

> The defendant company had a capital of Rs 1,92,000 divided into 1920 shares of Rs 100 each. By a special resolution the company resolved to reduce the capital to half, that is, to Rs 96,000 divided into 1920 shares of Rs 50 each. In other words, the paid-up capital was to be cancelled to the extent of Rs 50 on each share. The petitioner, a shareholder, opposed the reduction on the ground that there had been no loss of capital and, therefore, the reduction was unwarranted.

The question was whether a scheme of reduction can be confirmed only on the proof of the fact that there has been a real loss of capital. This fact was, however, proved by the company and, therefore, the court (now Tribunal) did not hesitate in confirming the scheme but cited with approval the opinion of Lord MACNAGHTEN in *Poole* v *National Bank of China Ltd*,[46] where his Lordship said: "The condition that gives jurisdiction is not proof of loss of capital or proof that capital is unrepresented by any available assets or that capital is in excess of the wants of the company. The jurisdiction arises whenever the company seeking reduction has duly passed a special resolution to that effect."

But a warning was issued in the case of *Caldwell* v *Caldwell & Co*:[47]

> ....if capital not lost or unrepresented by available assets were cancelled, it might be possible thereafter by some adjustment of the figures in the company's balance sheet to carry the amount so cancelled to the company's profit and loss account and so indirectly return the paid-up capital to shareholders, thus affecting the rights of creditors. It was therefore thought, if not necessary, at any rate wise and prudent to insist on some evidence of the fact of loss of capital.

"The court (now Tribunal) cannot, however, always so insist for the simple reason that the question of reducing capital is a domestic one for the decision of the majority. The company may reduce the capital of all its shareholders *pro rata*, or may reduce the shares of any individual shareholder or any class of shareholders wholly or in part. Although the court (now Tribunal) must see that the interests of the minority have been protected and there is no unfairness shown to them, but in doing so the court shall keep in view the consideration that the decision has been arrived at by businessmen who are fully cognizant of their necessities and are the best custodians of their interest and should therefore be slow to interfere."[48]

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45 AIR 1936 Cal 327.

46 1907 AC 229: [1904-07] All ER Rep 138: 96 LT 889.

47 [1916] SC (HL) 120: (1966) WN 70 Scotland.

48 The discretionary nature of the court's power has been explained by B. O. Rourke, *Reduction of Share Capital—The Reassertion of Discretionary Power*, (1970) 87 SALJ 161.

Moreover, lost capital can be written off even where it is still represented by available assets.[49]

The court's (now Tribunal) job becomes a little more difficult where there are two classes of shareholders enjoying different rights and the proposed resolution for reduction affects them differently. In such a case the court (now Tribunal) has to see that the scheme of reduction should be fair and equitable as between the ordinary and preference shareholders. But what is fair and equitable must depend upon the circumstances of each case. The decision of the House of Lords in *Scottish Insurance Corpn* v *Wilsons & Clyde Coal Co*[50] is an instructive illustration.

> Under an Act the colliery assets of a coal mining company were acquired. The company intended, after receiving compensation, to go into voluntary liquidation. Meanwhile, it proposed to reduce its capital by paying back the preference stock which would be thereby extinguished. The power to pay off the preferential stock was there in the articles. It was also provided that in the event of winding up the preference stock ranked before the ordinary to the extent of the amount paid thereon. The reduction was opposed by some preference stockholders on the ground (*inter alia*) that it deprived them of the advantage of their investment rather prematurely and, therefore, the proposed reduction was unfair.

It was, however, held that the proposed reduction was not unfair or inequitable, because, even without it, the preference shareholders would not be entitled to anything more than a return of their paid-up capital. Lord SIMONDS said:

> Whether a man lends money to a company at 7 per cent or subscribes for its shares carrying a cumulative preferential dividend at that rate, he cannot complain of unfairness if the company, being in a position lawfully to do so, proposes to pay him off. No doubt, if the company is content not to do so, he may get something he may never have expected but, so long as the company can lawfully repay him, whether it be months or years before a contemplated liquidation, I see no ground for the court refusing its confirmation. Funds being available for payment of the capital, the natural order is to pay off the capital which has priority and I see no glimmer of unfairness in the company doing so at the earliest possible moment.

The Calcutta High Court also faced a problem of this kind in *Hindustan Commercial Bank* v *H. G. E. Corpn.*[51]

> A company, having lost nearly the whole of its capital, proposed a scheme of reduction under which the preference shareholders had to forego

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49 *Hoare & Co Ltd, Re*, [1904] 2 Ch 208: [1904-07] All ER Rep 635 CA.

50 1949 AC 462: [1949] 1 All ER 1068. *See* also *Robert Stephen Holdings, Re*, [1968] 1 All ER 195 (Ch D); *Saltdean Estate Co Ltd, Re*, [1968] 1 WLR 1844: [1968] 3 All ER 829. Noted 1969 JBL 137: *Holders' Investment Trust Ltd, Re*, [1971] 2 All ER 289. In this case it was held that a cancellation of preference shares by repayment of the capital paid on them and also consistently with the rights attached to those shares did not involve variation of the rights of other shareholders. Followed in *House of Fraser* v *A C G E Investments Ltd*, [1987] BCLC 478 HL.

51 AIR 1960 Cal 637: (1960) 30 Comp Cas 367.

their accumulated arrears of dividend and 70 per cent of their capital and ordinary shareholders to forego 80 per cent of their capital. The scheme was approved by necessary majority at a separate meeting of preference shareholders and also at a general meeting of the company.

Some preference shareholders subsequently contended that "*prima facie* the whole of the capital paid-up on the ordinary shares should be cancelled before any part of the capital paid-up on preference shares is cancelled". The court (now Tribunal), however, sanctioned the scheme and said that "special circumstances may justify a departure from this *prima facie* rule". And the special circumstances here were that due to the loss of almost the whole of the paid-up capital of the company the only alternative to reduction was winding up in which case neither class of shareholders would have got anything.[52]

Where reduction involves paying back capital to shareholders, priority must be given to those who would be entitled to prior refund of capital in the winding up.[53]

Where reduction involves variation of class rights, the procedure prescribed by the Act and the company's articles must also be complied with.[54]

If the court (now Tribunal) is satisfied in all respects it may make an order confirming the reduction on such terms and conditions as it thinks fit.[55] The court may, for example, require the company to add to its name as the last words "*and reduced*" during such period as it thinks proper.[56] The company may also be directed to publish for public information the reasons for the reduction.[57] The company should get the reduction registered with the Registrar.[58]

Where reduction became necessary as a part of a scheme of amalgamation the court (now Tribunal) passed necessary orders for the purpose without the

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52 The Court relied upon the following authorities: *Credit Assurance and Guarantee Corpn Ltd, Re*, [1902] 2 Ch 601; *Bannatyne* v *Direct Spanish Telegraph Co*, (1886) 34 Ch D 287, 299-300; *Floating Dock Co of St Thomas Ltd, Re*, [1895] 1 Ch 691; *British & American Trustee & Finance Corpn* v *Couper*, [1894] AC 399: [1891-1904] All ER Rep 667. *See also* Surendra Nath, *Reduction of Shares Capital of a Company*, AIR 1969 Journal 7 and 18.

53 See *Prudential Assurance Co Ltd* v *Chatterley-Whitfield Collieries Ltd*, 1949 AC 512: [1949] 1 All ER 1094.

54 *Old Silkstone Collieries Ltd*, [1954] Ch 169 [CA]. Burden of proving unfairness lies on those who oppose the scheme. See *Carruth* v *ICI Ltd*, 1937 AC 707. In a takeover scheme all the ordinary shares were to be transferred to the acquiring company and the scheme was approved by 97% of the shareholders, the court approved the scheme; though the company had some "B" shares, a separate meeting of that class was considered to be not necessary. *BTR plc Re*, [2000] 1 BCLC 740 CA.

55 S. 102(1). The court has to watch the interest of even those shareholders who do not appear. *Indian National Press (Indore) Ltd, Re*, (1989) 66 Comp Cas 387 MP.

56 S. 102(2).

57 S. 102(2)(*b*).

58 S. 103. The detailed procedure of registration is explained in the section. The effective date of reduction is the date of filing the return of reduction with the Registrar. *CIT* v *Industrial Credit & Devt Syndicate Ltd*, [1989] 2 Comp LJ 266 Kant. A certified copy of the court order and the minute of reduction approved by the court should be filed. The Registrar issues a certificate which is conclusive that requirements have been complied with. The minute becomes incorporated in the capital clause of the memorandum.

need for following the special procedure except this that a special resolution which is a mandatory requirement must be observed.[59]

Liability of Members after Reduction [S. 104]

Liability of members in respect of reduced shares is explained in Section 104 of the Act. A member shall be liable to pay the amount deemed to have been unpaid on his shares. His liability is to pay the difference between the amount deemed to have been paid on his shares and the nominal value of the reduced shares.[60] However, the members' liability to pay the original nominal value of the shares can be restored in one case. Sometimes a creditor having the right to object to a reduction may have been left out of the list of creditors because of his ignorance of the proceedings or their effect on his interest and subsequently the company has become unable to pay its debts.[61] The court (now Tribunal) may, to meet the claim of such a creditor, order the members to pay that amount on their shares which they would have been liable to pay before the reduction.[62]

FURTHER ISSUE OF CAPITAL [S. 81]

Under Section 94 of the Act a company can at any time by passing an ordinary resolution at its general meeting resolve to increase its capital by such amount as it thinks expedient by issuing new shares. The time at which and the persons to whom new shares are to be allotted is an important question in company law. If the directors or the majority of shareholders are allowed to disperse the new issue at their discretion, they would naturally offer it to their nominees, thus adding to their own majority and reducing the strength of the minority. Section 81 partly deals with this problem.

Shareholders' pre-emptive right or rights shares

The section comes into play whenever it is proposed to increase the subscribed capital of the company (within the limit of authorised capital) by allotment of further shares after the expiry of two years from the formation of the company or after the expiry of one year from the first allotment of shares, whichever is earlier.[63]

The new issue must be offered to the existing holders of equity shares in the proportion, as nearly as the circumstances admit, of the shares held by them.[64]

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59 *Novopan India Ltd, Re*, (1997) 88 Comp Cas 596 AP and *Sumitra Pharmaceuticals & Chemicals Ltd, Re*, (1997) 88 Comp Cas 619 AP.

60 S. 104(1).

61 S. 105 penalises any officer of the company who conceals information as to creditors.

62 S. 104(1) proviso. Sub-section (2) says that the rights of the contributories among themselves shall not be affected. *See also* S. 105 which imposes penalty for concealing the name of any creditor.

63 S. 81(1). Section I of SEBI Guidelines for Investor and Creditor Protection, 1992 prescribes the minimum interval of 12 months between two issues. *Ashok V Doshi* v *Doshi Time Industries P Ltd*, (2001) 104 Comp Cas 306 CLB, 2 years had still not passed when the next issue was made. Section not applicable.

64 S. 81(1)(*a*). *Nupur Mitra* v *Basubani P Ltd*, (2002) 108 Comp Cas 359 CLB, the provision is mandatory, increase was with the consent of the whole Board of the family company, lawful, though there was absence of minutes and notices to members.

"The object of the section obviously is that there should be an equitable distribution of shares and the holding of shares by each shareholder should not be affected by the issue of new shares."[65]

Offer must be made to the existing holders of equity shares in the company in proportion, as nearly as the circumstances admit, to the capital paid up on those shares. Offer is to be made by giving a notice specifying the number of shares offered.[66] The notice must fix a time which should not be less than fifteen days from the date of the offer within which the offer must be accepted.[67] The notice must also inform the shareholders that if the offer is not accepted within the specified time, it shall be deemed to have been declined. Again, the notice has to inform the shareholders that they have the right to renounce all or any of the shares offered to them in favour of their nominees.

If a shareholder has neither nominated anyone nor accepted the shares himself, the board of directors will get the discretion to dispose of the shares declined in such manner as they think most beneficial to the company.[68] Similarly, if after carrying out proportional allotment as nearly as the circumstances admit, some shares are left, they may be disposed of by the directors in such manner as they think most beneficial to the company.[69]

Role of directors' discretion and judicial control

Subject to these restrictions, directors enjoy the full discretion of deciding whether an increase in the capital of the company is necessary or not and at what particular time the capital should be increased. This appears from the decision of the Bombay High Court as affirmed by the Supreme Court in *Nanalal Zaver* v *Bombay Life Assurance Co.*[70]

> Tempted by the soundness of a company, one *S* purchased a majority of its shares in the open market. The directors immediately came out with a further issue of capital and allotted it to the existing members in accordance with Section 105(*c*) (of Act, 1913) [now Section 81]. Two of the

65 *Nanalal Zaver* v *Bombay Life Assurance Co*, AIR 1949 Bom 56: 50 Bom LR 413.

66 See *Jadabpore Tea Co Ltd* v *Bengal Dooars National Tea Co*, (1984) 55 Comp Cas 160 Cal, where the notice was under certificate of posting and the Court presumed delivery.

67 The Delhi High Court held in *Shrimati Jain* v *Delhi Flour Mills Co Ltd*, (1974) 44 Comp Cas 228 that a notice posted within Delhi and giving seventeen days' time to accept was a good notice. Such a letter is likely to be delivered the next day and thus leaves a time of fifteen clear days exclusive of the date of posting and of delivery. The court also pointed out that the validity of an allotment under the section cannot be challenged in the absence of the allottee as that would be against the principle of natural justice. *See* at 250. Letters of offer have to be sent by registered post.

68 S. 81(1)(*d*).

69 *V Shanmugasundaram* v *Enerald Automobiles Ltd*, (2001) 103 Comp Cas 1109 CLB, rights shares first offered to existing shareholders and then to outsiders, allotment valid.

70 AIR 1949 Bom 56: 50 Bom LR 413. The directors' discretion in this connection was emphasised in *Miheer H Mafatlal* v *Mafatlal Industries Ltd*, (1996) 87 Comp Cas 705 Guj. The court added that an allotment of shares is a contract. If it is made in contravention of a court injunction, would be contrary to public policy and void as between the company and the allottee. If the company is in need of more capital in accordance with director decision, it can make further issue, the only constraints being that the directors should decide the matter in good faith and proceed in accordance with the requirements of S. 81, *Milan Sen* v *Guardian Plasticote Ltd*, (1998) 91 Comp Cas 105 Cal.

shareholders who had sold their interest to *S* objected to the scheme on two grounds, firstly, that the company was in no need of further capital and, therefore, the allotment was not made in the *bona fide* interest of the company, and, secondly, some 272 shares of the total new issue were not offered to the shareholders at all.

Both these contentions were rejected. Regarding the second, it was held that "the legislature did not intend that every one of the shares had to be offered to the members in proportion to the existing shares held by each member. Such shares had to be offered only as nearly as the circumstances admit" and that was done in the present case. As for the first argument, the Bombay High Court, as upheld by the Supreme Court, observed:

> The scheme of the section is fairly clear. It is left to the discretion of directors to decide whether an increase in the capital of the company is necessary or not. It is also left to their discretion to determine at what particular time the capital should be increased.... Once it is established that the company is in need for funds, then, whatever other motives might have actuated the directors, the Court will not interfere with their discretion. However mixed the motives might be, if it is established that in fact the company was in need of funds, then it could not be said that the exercise of their fiduciary powers by the directors was not a *bona fide* exercise. It is only when that discretion is exercised solely for the personal ends of the directors, for their personal aggrandisement, for keeping themselves in power, then undoubtedly that discretion cannot be said to have been exercised *bona fide*.[71]

Excluding operation of the section

The operation of this section can, however, be excluded and the new shares offered to outsiders to the total exclusion of the existing shareholders in the following two cases:[72]

1. If the company has, by passing a special resolution, resolved to allot the new issue in a different manner than that provided in the section, or

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71 *See* MAHAJAN J at 179, AIR 1950 SC 172. Cf. *Percy* v *Mills S & Co*, [1920] 1 Ch 77; *Hogg* v *Cramphorn Ltd*, [1966] 3 All ER 420: [1967] Ch 254; noted K. W. Wedderburn, *Shareholders' Control of Directors' Powers*, [1967] 30 Mod LR 77. *See also* L. H. Leigh, *Companies Act, 1967*, (1968) 31 Mod LR 183, 186, where the learned writer maintains that *Hogg* v *Cramphorn Ltd*, [1966] 3 All ER 420: [1967] Ch 254 shows that "it will be improper to issue shares to management primarily with a view to maintain control, and the directors will have to ensure that an issue is made in the company's interest if litigation is to be avoided". *Vijay M. Shah* v *Flex Industries Ltd*, (2001) 103 Comp Cas 1063 Delhi, a case filed under S. 81 alleging failure of company to send rights offer in time because of *mala fides*, fraud and oppression, the court said that it was in essence a matter under Ss. 397-398. It should have gone before the CLB (now National Company Law Tribunal).

72 S. 81(1-A). *Janaki Printing P Ltd* v *Nadar Press Ltd*, (2001) 103 Comp Cas 546 CLB, ordinary resolution by shareholders who were fully informed, considered to be sufficient for expression of shareholders', will.

2. If an ordinary resolution to that effect has been passed and the Central Government is satisfied, on an application made by the board of directors, that the proposal to offer the shares to outsiders is most beneficial to the company.

The requirement of special resolution was introduced by an amendment in 1960.[73] Before this amendment the right could be excluded by an ordinary resolution. But in either case the question arises whether the exercise of this majority power is governed by the fiduciary principle or whether the majority can act in its personal interest in disregard to that of the company. This in essence was the question before the Supreme Court in *Shanti Prasad Jain* v *Kalinga Tubes Ltd.*[74]

> The shares of one private company were held equally by two groups. The petitioner was introduced to provide financial and administrative help. He was allotted shares equal to both the groups and was made chairman of the board of directors. The company's business was successful. In order to avail of the loan facilities provided by the Orissa Government the company was converted into a public company. A substantial increase of capital was proposed. The two groups having majority both in the board and general meeting resolved to offer and allotted the new issue to outsiders selected by them.

The question was whether the majority power was exercised in good faith in the interest of the company or only to deprive the petitioner of his right under Section 81. If the voting power of the new allottees was utilised by the majority group, seventy-five per cent of the votes would concentrate in their hands. But that, the court held, was not sufficient to show that there was a "combination"[75] to squeeze out the petitioner. WANCHOO J said: "The seven persons to whom the new shares were allotted were respectable persons of independent means and there was nothing to show that they were stooges of the majority groups."

The decision, with due respect, does not seem to take into account the footing on which majority powers stand. For "the majority has the right to

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73 Companies (Amendment) Act, 1960.

74 [1965] 1 Comp LJ 193: AIR 1965 SC 1535: (1965) 35 Comp Cas 351. Again affirmed by the Supreme Court in *Needle Industries (India) Ltd* v *Needle Industries Newey (India) Holding Ltd*, (1981) 3 SCC 333: (1981) 51 Comp Cas 743: AIR 1981 SC 1298. The court will set aside the allotment where it would appear to have been made only to reduce the strength of a shareholder. *Jadabpore Tea Co Ltd* v *Bengal Dooars National Tea Co*, (1984) 55 Comp Cas 160.

75 MISRA J in *Kalinga Tubes Ltd* v *S. P. Jain*, [1964] 1 Comp LJ 117. A similar compulsion was there in *Jacques Taru Lalvani* v *JBA Printing Inks Ltd*, (1997) 88 Comp Cas 759 Bom because a private company's capital had to be increased on the eve of making it a public company. Any incidental benefit to the directors cannot be a decisive factor. *N. Jagan* v *Investment Trust of India Ltd*, (1996) 85 Comp Cas 75 Mad, statutory right of shareholders to exclude pre-emptive rights. The court did not interfere in the shareholders' resolution authorising the directors to allot further issue to the promoters' group. A similar resolution was not interfered with in *Kothari Industrial Corpn. Ltd* v *Maxwell Dyes & Chemicals P Ltd*, (1996) 85 Comp Cas 79 Mad, where also the shareholders resolved that the further issue be allotted to NRIs, overseas corporate bodies and promoters' group. This decision was affirmed by the Division Bench in *Maxwell Dyes and Chemicals (P) Ltd* v *Kothari Industrial Corpn Ltd*, (1996) 85 Comp Cas 111 Mad.

control; but when it does so, it occupies a fiduciary relation towards the minority, as much as the corporation itself, or its officers or directors."[76]

Where the Section does not Apply

The above restrictions, however, do not apply to any increase in the subscribed capital caused by the exercise of an option attached to debentures issued or loans raised by the company to convert such debentures or loans into shares or to subscribe for shares in the company.[77] The option to convert must be contained in the terms of issue of the debentures or loan. Again, approval of the Central Government for such terms must have been obtained before the issue was made or it should have been made in conformity with the rules, if any, made by the Central Government. It is also necessary that the terms should have been approved by a special resolution of the company except where the loan is from the Government or any institution specified by it.[78] A private company is also exempt from the provision.[79]

The English Companies Act, 1948, does not provide for pre-emptive rights.[80] "England has never adopted this doctrine as a compulsory legal rule.... The only restraint on the directors is that entailed by the rule that they must act as fiduciaries when issuing further capital."[81] One aspect of this fiduciary principle is that the directors must not allot new shares to themselves or their nominees solely for the purpose of maintaining themselves in power. Thus they have been restrained from issuing shares to enable themselves to control the next general meeting,[82] or to pass a special resolution.[83] The fiduciary principle has been reaffirmed in the cases of *Hogg* v *Cramphorn Ltd*[84] and *Bamford* v

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76 BRANDIES J in *Southern Pacific Rly Co* v *Bogert*, 250 US 483, 492. Many such opinions have been cited by Berle and Means, THE MODERN CORPORATION AND PRIVATE PROPERTY, 258 (1932); Carlos L. Israels, *Are Corporate Powers still held in Trust*, (1964) 64 Col LR 1446.

77 S. 81(3).

78 Proviso to S. 81(3) as *substituted* by the Amendment Act of 1963.

79 S. 81(3)(*a*). See *Needle Industries Ltd* v *Needle Industries Newey (India) Holding Ltd*, (1981) 3 SCC 333; (1981) 51 Comp Cas 743; AIR 1981 SC 1298. The decision was to the effect that S. 81 would not apply to private companies which have become deemed public companies by virtue of S. 43-A and which have retained the features of a private company. *V. Radha Krishnan* v *P. R. Rama Krishnan*, (1993) 78 Comp Cas 694 Mad; (1995) 17 Corpt LA 63, here the shareholding was that of a company in winding up and it was held that its proportionate shares ought to have been offered to it.

80 *Abbotsford Hotel Ltd* v *Kingham*, [1910] 102 LT 118; [1909] 101 LTR 917. For American literature on the subject of pre-emptive rights, following articles may be consulted: Henry S. Drinker, Jr., *The Pre-emptive Right of Shareholders*, [1929-30] 43 Harv LR 586; *The Right of Stockholder to New Stock*, [1908-09] 18 Yale LJ 101; Victor Morawetz, *The Pre-emptive Right of Shareholders*, [1928-29] 42 Harv LR 186; Gower, *British & American Corporation Law*, [1956] 69 Harv LR 1369, 1380; *Freezing Out Minority Shareholders*, [1961] 74 Harv LR 1630, 1631-32. *See also* Avtar Singh, *Shareholders' Pre-emptive Right: A Comparative Study*, [1969] Shareholders' Journal 16.

81 Gower, *British and American Corporation Law*, 69 Harv LR 1369, 1380.

82 *Fraser* v *Whalley*, (1864) 2 H & M 10; 71 ER 361; [1861-73] All ER Rep Ext 1456; *Percy* v *S. Mills & Co*, [1920] 1 Ch 77; [1918-19] All ER Rep 313.

83 *Punt* v *Symons & Co*, [1903] 2 Ch 506; [1900-03] All ER Rep Ext 1040.

84 [1966] 3 All ER 420; 1967 Ch 254; (1967) 30 Mad LR 77. Considered by K. W. Wedderburn, *Shareholders' Control of Directors' Powers: A Judicial Innovation*, (1967) 30 Mod LR 7 and *Going the Whole Hogg* v *Cramphorn Ltd*, (1968) 31 Mod LR 688. *See also* 1964 JBL 51.

Bamford.[85] In both cases the directors had to face a take-over bid and by way of defence new shares were allotted. In the first case the allotment was made to certain trustees for the benefit of the company's employees, the company providing an interest free loan for the purpose. This helped the directors to regain majority at a general meeting. BUCKLEY J said:

> Assuming that the directors acted in good faith and they believed that the establishment of a trust would benefit the company and that avoidance of take-over would also benefit the company, I must still remember that an essential element of the scheme, and its primary purpose, was to ensure control of the company by the directors and those whom they could confidently regard as their supporters. Was such a manipulation of the voting position a legitimate act on the part of the directors?

The learned Judge held that it was not, unless it was affirmed by a majority of shareholders in general meeting. The decision was accordingly deferred until the wishes of shareholders could be ascertained in a general meeting at which new allottees would not vote.

In the other case the directors took the precaution of having the shareholders' sanction to the allotment. The court held that even assuming that the allotment was not made in the *bona fide* interest of the company, the members could ratify it, they not being subject to the fiduciary duty of directors to act in the best interest of the company. The Court of Appeal affirmed the decision but on a different ground. It held that according to the articles, the residual power of allotment was with the company and the company exercised it in its own right and not in the right of the board.

Freezing out Techniques

Subject to these considerations, however, issuing new shares with the dominant purpose of diminishing the voting power of the minority shareholder is an abuse of their position by a majority of the shareholders.

> A small private company had only two shareholders, the plaintiff holding 45% and her aunt 55%. The aunt was a director along with some others who were not shareholders. A resolution was passed increasing share capital which was to be allotted partly to the directors and partly in trust for employees. The plaintiff's holding would thereby be reduced to half and that of the majority group along with the new shares would be increased to 75%.

The House of Lords restrained the scheme. The dominant purpose was to diminish the voting strength of the minority and the resolution was adopted to serve only that purpose.[86]

One of the results of these cases is the development of the "proper purpose" doctrine which requires directors to use their powers in good faith only for the purpose for which they are meant. A Canadian court found that the directors of a company had issued shares in good faith to a third person in order to wipe off

85 [1969] 2 WLR 1107: [1969] 1 All ER 969: noted 1969 JBL 49: 1970 Ch 212.

86 *Clemens* v *Clemens Bros Ltd*, [1976] 2 All ER 268 Ch D.

the control by a majority shareholder and held that the proper purpose doctrine was merely an aspect of the broader principle that directors must act *bona fide* and, therefore, there was no breach of duty.[87] But this decision seems to have been not approved by the Privy Council in a case where their Lordships held that the directors were in breach of their proper purpose duty irrespective of their *bona fides*.[88]

Besides this, the stock exchange regulations (effective in England) now require the new issues of quoted securities to "be offered in the first place to the equity shareholders unless those holders have agreed in general meeting to other specific proposals".[89]

Private Companies and Convertible Issues

The section does not apply to private companies,[90] or to increase of the subscribed capital of a public company by the exercise of an option attached to debentures issued or loans raised by the company. It is necessary that such scheme of conversion was either approved by the Government or is in accordance with the rules, if any, made by the Government and in the case of conversion of loans or debentures of private holders, that the scheme has been approved by the shareholders of the company by a special resolution.

Employees Stock Option

This expression has been defined in Section 2(15-A) as follows:

> "Employees stock option" means the option given to the wholetime directors, officers or employees of a company, which gives such directors, officers or employees the benefit or right to purchase or to subscribe at a future date, the securities offered by the company at a pre-determined price."[91]

"Option in securities" has been given the same meaning as in Section 2(*h*) of the Securities Contracts (Regulation) Act, 1956.[92]

Power to convert loans into capital [S. 81(4) to (7)]

By the amendment of 1963 the Central Government has taken a new power of converting into shares any debentures issued to or loan taken from the Government by a company. Where a company has issued any debentures to the Government or has taken any loan from it, the Central Government may direct

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87 *Teck Corpn* v *Millar*, (1972) 33 DLR (3d) 288 Canada.

88 *Howard Smith* v *Ampol Petroleum*, 1974 AC 821 PC. All the different view points on the subject have been collected and considered by Kenneth C. K. Chow, *Proper Purpose Doctrine and the Companies Bill*, [1979] New LJ 123.

89 *See* Clive M. Schmitthoff, *The Issue of Securities in Great Britain*, 1969 JBL 1, 4.

90 The section does not apply to private companies including a private company which is subsidiary of a public company. The interests of shareholders of such companies are usually protected by pre-emptive clauses in articles of association. *Ashok Doshi* v *Doshi Time Industries (P) Ltd*, (2000) 38 CLA 278 (CLB). Any decision about the applicability of the section to such companies is likely to go wrong if the state of the company's articles is not taken into account, *Jayanthi Detergents (P) Ltd* v *Secretary, CLB*, [1999] 3 Comp LJ 237 AP.

91 Introduced by the Amendment Act, 2000.

92 S. 2(31-A) as introduced by the Amendment Act, 2000.

that such debentures or loan (or any part of it) shall be converted into shares in the company. The power is to be exercised only if such conversion appears to be necessary in the public interest. The conversion shall be on such terms and conditions as appear to the Government to be reasonable in the circumstances of a particular case. Regard shall be had to the financial position of the company, the original terms of the issue, the rate of interest, the capital of the company, its liabilities, its reserves, its profits during the preceding five years and the current market value of the company's shares. Further, the Government must exercise the power at a time when it will not cause undue violent fluctuations in the market value of shares. Care has also to be taken to avoid serious imbalance in the ratio of debt to equity capital of the company.

If the terms and conditions proposed by the Government are not acceptable to the company, it may within thirty days prefer an appeal to the court and the decision of the court shall be final. Subject to the decision of the court, the order shall become final and conclusive.[93]

A copy of every order proposed to be issued by the Government is to be laid in draft before each House of Parliament for a total period of thirty days.[94]

A power of this kind opens the door to backdoor nationalisation.[95]

Section 94-A inserted by the Amendment of 1974 provides that where the Government or any public financial institution has converted its debentures or loans into capital, the capital of the company shall thereby stand increased by an equal amount and its memorandum altered accordingly. The Central Government is required to send a copy of the order to the Registrar so that he may effect the necessary alterations in the company's memorandum.

Variation of shareholders' rights or class rights [S. 106]

The share capital of a company can be divided into two different classes of shares, namely, preference shares and ordinary shares. Frequently, and obviously, rights attached to one class of shares may be different from those attached to the other class. A shareholder who was given the right to purchase the shares of the company on a pre-emptive basis was held to constitute a special class distinguishing him from other shareholders who did not have any such right, and consequently, his right was not permitted to be taken away without his consent.[96] If it is proposed to change the rights of any class, certain procedure has to be followed. Firstly, there should be a provision in the memorandum or articles of the company entitling it to vary such class rights or, at any rate, there should be nothing in the terms of issue of the shares of that class prohibiting such a variation.[97] Secondly, the holders of three-fourths of the issued shares of that class must have given their consent in writing or a special

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93 S. 81(7).

94 S. 81(6).

95 *See* 1970 JBL 242, reviewing Avtar Singh's, COMPANY LAW.

96 *Cumbrian Newspapers Group Ltd* v *Cumberland & Westmorland Herald Newspaper & Printing Co Ltd*, [1986] 1 WLR 26: (1986) 2 All ER 816: [1987] 2 Comp LJ 39.

97 S. 106(*a*) and (*b*). See *Sitarama Reddy* v *Bellary Spg & Wvg Co*, (1984) 56 Comp Cas 817 Ker where the resolution was not passed in accordance with the provisions.

resolution sanctioning the variation must have been passed at a separate meeting of the shareholders of that class. Thirdly, the holders of at least ten per cent of the shares of that class who did not consent to or vote in favour of the resolution may apply to the Tribunal and then variation shall not take effect unless and until it is confirmed by the Tribunal.[1] An application should be made within twenty-one days of the date of consent or resolution.[2] The Tribunal shall grant a hearing to the applicant and any other persons who apply to the Tribunal to be heard and appear to be interested in the application.[3] If the Tribunal, having regard to all the circumstances of the case, is satisfied that the variation would unfairly prejudice the shareholders of that class, it would be disallowed. But if the scheme appears to be reasonable and fair it would be confirmed. The decision of the Tribunal is final.[4] The company shall, within thirty days, send a copy of the Tribunal's order to the Registrar.[5]

New issue of preference shares ranking *pari passu* with the existing shares does not amount to variation so as to require the consent of preference shareholders.[6] The conversion of the loans of an ex director into shares was held not to violate class rights, although voting power of shareholders was affected. Proper procedure was followed and the scheme was also of *bona fide* nature.[7]

Share warrants [Ss. 114, 115]

A public company has the right to convert its fully paid-up shares into share warrants,[8] provided, of course, there is an authority to that effect in its articles and the previous approval of the Central Government has been obtained. The advantage of issuing share warrants is that transfer of warrants becomes very easy. A share warrant issued by a company has to be under its seal and must state that the bearer of the warrant is entitled to the specified number of shares. He may transfer the shares comprised in the warrant by simple delivery of the warrant. Registration of transfer with the company is not necessary. Payment of dividends may be made by issuing coupons with warrants or otherwise.

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1 S. 107(1).
2 S. 107(2).
3 S. 107(3).
4 S. 107(4).
5 S. 107(5) which also imposes penalty for default.
6 *White* v *Bristol Aeroplane Co*, [1953] 1 All ER 40: [1953] Ch 65: 2 WLR 144. See *PSI Data Systems Ltd, Re*, (1999) 98 Comp Cas 1: AIR 2000 Ker 23, where a company unilaterally and without the participation of preference shareholders decided to redeem their stake, the court said that the scheme would have to satisfy the requirements of S. 80(1) and approved under S. 391.
7 *Girish Kumar Kharia* v *Industrial Forge & Engg Co Ltd*, (2000) CLC 105 (Pat). The scheme could not be implemented without the permission of the Board of Industrial & Financial Reconstruction, the company being under a scheme prepared under Sick Industrial Companies (Special Provisions) Act, 1985. *Girish Kumar Kharia* v *Industrial Forge & Engg Co Ltd*, (2001) 103 Comp Cas 150 Pat, a variation which affects enjoyment of rights without affecting the right itself is not actionable, e.g., a valid increase of capital which causes proportional diminition of voting rights.
8 Partly paid-up shares cannot be converted into warrants. *Home & Foreign Investment Co, Re*, [1912] 1 Ch 72: 106 LT 259.

On the issue of a share warrant the company shall strike out from its register of members, the name of the member in respect of the shares comprised in the warrant just as if he had ceased to be a member. The following particulars shall be entered in the register:

1. The fact of the issue of the warrant.
2. A statement of the shares specified in the warrant, distinguishing each share by its number.
3. The date of issue of the warrant.

The bearer of a share warrant has, subject to the articles of the company, the right to surrender his warrant for cancellation and to have his name entered in the register of members. The articles of a company may provide that the bearer of a share warrant shall be deemed to be a member of the company for all or any purposes defined in the articles.[9]

Purchase by company of its own shares [S. 77]

It is not open to a company to purchase its own shares, for Section 77 declares in so many words that "no company limited by shares, and no company limited by guarantee and having a share capital, shall have power to buy its own shares, unless the consequent reduction of capital is effected and sanctioned in pursuance of Sections 100 to 104 or of Section 402".[10] Buying its own shares by a company involves a permanent reduction of capital without sanction of the court which is "illegitimate" and "in violation of statute law". "The object of the section is to prevent a person from acquiring control of a company and paying for its shares out of the accumulated assets of the company itself, in other words, to prevent a person from plundering the coffers of the company for his own benefit."[11]

For the same reason a subsidiary company is not allowed to purchase the shares of its holding company.

This principle was laid down by the House of Lords as early as 1887 in *Trevor* v *Whitworth*.[12]

> The articles of a company contained a clause to the effect that "any share may be purchased by the company from any person willing to sell it, and at such price as the board think reasonable". A director bought on behalf of the company 533 shares from the executors of a shareholder. The company, before paying the whole price, went into liquidation and the executor claimed the money. It was held that "the whole transaction was ultra vires the company". "In my opinion", said Lord WATSON, "the application of the company's funds in furtherance of any such object is

9 S. 115(5). Sub-section (*b*) provides penalty for default. The provisions relating to shares cease to apply to so much of the company's capital as has been converted into stock. S. 96.

10 S. 77(1).

11 Paul L. Davies, editing *Fowlie* v *Slater*, (1979) 129 New LJ 465 in 1980 JBL 48.

12 (1887) 12 App Cas 409: [1886-90] All ER Rep 46.

altogether illegitimate because it is foreign to the proper business of the company and in violation of statute law".[13]

The reason for the rule was explained in a subsequent case by JESSEL MR in the following words:

> The creditor. . . gives credit to the company on the faith of the implied representation that the capital shall be applied only for the purposes of the business and has. therefore, a right to say that the corporation shall keep its capital and not return it to the shareholders.[14]

To make the restriction really effective sub-section (2) provides that no public company or its subsidiary private company shall in any way provide money or financial assistance to any person to enable him to buy any shares in the company or in its holding company. Thus an agreement to provide a loan for purchase of the company's own shares is void and a guarantee given for the performance of the agreement is also void.[15]

An agreement between a company and the managing director of group companies under which he was to transfer his shares in one of the companies to his son and the company was to pay him salary, bonus and pension on his retirement was held to be not an agreement to pay for the purchase of the company's shares. The company was to pay him salary etc. for his working and services to the company. Thus there was no reduction in the net assets of the company and no financial assistance in violation of the provisions.[16]

Exceptions.—The sub-section, however, does not prohibit the following kinds of transactions:

1. The lending of money by a banking company in the ordinary course of its business.
2. The provision of money for the purchase of fully paid shares in the company by trustees for and on behalf of the company's employees.[17] (Employee share schemes).

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13 *See* also *Indian Iron & Steel Co* v *Dalhousie Holdings Ltd*, AIR 1957 Cal 293.

14 *Exchange Banking Co, Re*, (1882) 21 Ch D 519, 533-34; 48 LT 86 CA. *See also* W. Strachan, *Return of Company's Capital to Shareholders*, (1910) 26 LQR 231.

15 *Heald* v *O'Connor*, [1971] 2 All ER 1105. Where a loan was given by a company to a person to enable him to purchase another company's shares and that other company issued a debenture to the lending company for the loan, the arrangement was held to be valid. *Victor Battery Co Ltd* v *Curry's Ltd*, [1946] Ch 242: [1946] 1 All ER 519. This decision was questioned and has not been followed in the subsequent case of *Heald* v *O'Connor*, [1971] 2 All ER 1105: [1971] 1 WLR 477. *Carney* v *Herbert*, 1985 AC 301 PC, where it was held that where the unlawful element in the agreement could be severed from the lawful part, the latter would be enforceable.

16 *Parlett* v *Guppys (Bridport) Ltd*, (1996) 2 BCLC 34 CA.

17 *Hogg* v *Cramphorn Ltd*, (1967) Ch 254: [1966] 3 All ER 420: (1967) 30 Mad 5 LR 77, where a trust for the purchase of a company's shares on behalf of its employees was financed by an interest free loan by the company. Section 153 of the English 1989 Act widened the provision to allow companies to guarantee loans made to such schemes. The new provision adds good-faith criteria to such schemes. Assistance can also be given by group companies for trading under the scheme.

3. Lending money by a company to its employees to enable them to buy fully paid shares in the company and to hold them by way of beneficial ownership. The amount of loan cannot exceed the employees' salary for a period of six months.[18] The word "employee" for this purpose does not include directors or managers.[19]

The provision in the first exception is to protect banks. They have to make loans in the ordinary course of their business and they can hardly supervise the purpose for which the borrower uses the loan money. Hence if a borrower from a bank uses the money for purchasing the bank's shares, the bank and its officers will be protected from liability. The words "lending in the ordinary course of business" are not defined. An English court held that where money is given for the very purpose of purchasing the bank's shares that would not be lending in the ordinary course of business and the provision would be violated.[20]

Redemption of preference shares constitutes an exception to the restriction contained in the section though redemption is the same thing as a company buying its own shares.[21]

Consequences of illegal financing.—Where the directors provide the company's money for the purchase of its own shares outside the scope of the above exceptions, it is a breach of trust for which they are liable. "The illegality of the transaction could not shield those responsible for the transaction by virtue of their fiduciary position."[22] The transaction is ultra vires and incapable of ratification. Any shareholder can sue on behalf of the company for restituting the company to its former position. But may the company abandon its claim? The court of Chancery Division faced this problem in *Smith* v *Crofit (No 2)*.[23] A 14.5% minority shareholder showed that payments were made to associated companies for purchasing the company's shares, and that the same were illegal. The circumstances as they developed disentitled the company from proceeding

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18 S. 77(3).

19 S. 77(2)(*c*). *See also* sub-section (4) which imposes penalty for default in this connection. See *Financial Assistance by a Company in the Purchase of its Shares*, (1965) XLIII Can BR 502; Jass B. Murry, *Financial Assistance by a Company in Connection with Purchase of its Shares*, (1960) 3 ALJ 17; *South Western Mineral Water Co Ltd* v *Ashmore*, [1967] 2 All ER 953: [1967] 1 WLR 1110: noted 1967 JBL 360.

20 *Fowlie* v *Slater*, (1979) 129 New LJ 465. For details *see* Keith Walmsley, *Lending in the Ordinary Course of Business*, (1979) 129 New LJ 801. The court followed *Steen* v *Law*, [1964] AC 287 PC, the effect of which is that loans deliberately made for the very purpose of financing the purchase of the company's shares are not in the ordinary course of business. *See also* Keith Walmsley, *Lessons from the Stonehouse Investigation*, [1978] New LJ 252.

21 *Anarkali Sarabhai* v *CIT*, (1997) 3 SCC 238: (1997) 89 Comp Cas 28 (SC). Redemption is different from buyback, *Barclays Bank Plc* v *British & Commonwealth Holdings Plc*, (1996) 1 BCLC 1 Ch D and CA.

22 *Selangor United Rubber Estates Ltd* v *Cradock*, [1969] 3 All ER 965: [1968] 2 All ER 1073. Noted, *Directors' Liability for Breach of Trust*, 1969 JBL 47, 49, where the learned writer supports the decision with reference to the Privy Council case of *Steen* v *Law*, 1964 AC 287. But whether the money provided by the company to the third party contrary to the section can be recovered is "an open question". But see *Victor Battery Co Ltd* v *Curry's Ltd*, [1946] Ch 242: [1946] 1 All ER 519 and *Essex Aero Ltd* v *Cross*, unreported, noted, 1969 JBL 49; *Spink Ltd* v *Spink*, [1936] Ch 544.

23 [1987] 3 All ER 909 Ch D.

against the matter because a great majority of the shareholders, including a financial institution which was independent of the majority block, resolved to abandon or compromise the company's rights and the company thereby having become disentitled from enforcing its rights, it was not open to a minority shareholder to reopen a chapter of closed rights.[24]

A buy-back of shares by the company was held to be invalid where the company did not have the necessary distributable profits as required by Section 160(1)(*a*) of the [English] Companies Act, 1985. The relevant accounts were qualified and auditors' statement that the qualification was not material had not been made and laid before the company in general meeting as required by the Act. The purchase was held to be invalid even though the auditors' believed that the company had sufficient distributable reserves and they could have made a statement to that effect.[25]

The company's bank paid the company's cheque not knowing that the withdrawal was a part of an elaborate arrangement to cause the company's own funds to be used to finance a take-over. The bank was held liable despite its being unaware of the real purpose of the transaction. UNGOED THOMAS J said (in *Selangor No. 3*) that the bank paid the cheque out of the company's money in circumstances known to the bank before the payment in which a reasonable banker would have concluded that the payment was to finance the purchase of the stock in the company.[26]

A company's fully paid shares may be transferred to a nominee or trustee of the company for its benefit. There is nothing wrong where the company does not become its own member, or does not have to pay for its own shares or does not reduce its capital. Where shares were allotted to partners of a firm for taking over their business and the allotment happened to exceed the value of assets acquired; allottees returned the extra shares to the company which were taken in the name of a trustee for the benefit of the company, the court could find nothing wrong with it.[27] Similarly, where a shareholder bequests by his will his shares in the company to the company itself, the latter can hold them in the name of a trustee for its benefit.[28] Voting rights on such shares are exercisable by the directors of the company.[29]

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24 For a critical appreciation of the decision, *see* L. S. Sealy, CASES AND MATERIALS IN COMPANY LAW, 486 (4th Edn, 1989).

25 *B. G. D. Roof Bond Ltd* v *Doughlas*, (2000) 1 BCLC 401 Ch D. A buy-back scheme was not restrained because if the shareholders had any grievances, they could resort to proceedings for prevention of oppression etc. *J. K. Puri* v *H P State Industrial Devp Corpn*, (1998) 93 Comp Cas 491 HP.

26 *Selangor United Rubber Estates* v *Cradock (No 3)*, [1968] 1 WLR 1555: [1968] 2 All ER 1073 and *Karak Rubber Co* v *Burden (No 2)*, [1972] WLR 602. An amendment was held not liable for the fact that his sub-underwriter had carried on the financing of his portion of the shares with the company's money. Knowledge of the misuse of the company's money could not be imputed to him from the fact that his sub-underwriter was the Chief Executive of the company, *Eagle Trust Plc* v *SBC Securities Ltd (No 2)*, (1996) 1 BCLC 121 Ch D.

27 *Kirby* v *Wilkins*, (1929) 2 Ch 444.

28 *Castiglione's Will Trusts*, [1958] CR 549: [1950] 2 WLR 400: [1958] 1 All ER 480.

29 Jenkins Committee has recommended that this should not be allowed as directors can thereby perpetuate themselves. Para 156. *See also* the decision of the House of Lords in

Exemption of private company from financial assistance.—Sub-section (2) of Section 77 confines itself to a private company and its subsidiary private companies. This leaves a private company free to provide loans, guarantees or securities for the purpose of financing the purchase of its own shares. Such assistance should be confined to use of funds otherwise available for dividend distribution. If it is to go beyond that, the book value of the net assets of the company must remain untouched. Sections 154-158 of the English 1989 Act prescribe an elaborate procedure for the exercise of this power requiring a statutory declaration of the financial position, auditors' report, special resolution of shareholders and the right of dissenting holders of 10% shares to apply to court.

Buy-back of shares [S. 77-A]

Traditionally, subject only to a few exceptions specified in S. 77, companies were not permitted to purchase their own shares. Section 77-A, brought in by the Companies (Amendment) Act, 1999, has caused this structural change in the theme and philosophy of Company Law that, subject to the restrictions envisaged in the section, a company may buy back its own shares.

Sub-section (1) indicates the fund out of which the exercise of buy back is to be financed. The sources allowed are the company's free reserves, securities premium account, proceeds of an earlier issue. No buy back of any kind of shares or other specified securities can be made out of the earlier proceeds of the same kind of shares or the same kind of other specified securities. The expression "free reserves" has the same meaning as is attached to it in S. 372-A.

Sub-section (2) prescribes certain formalities. There should be a provision in the articles authorising buy back of shares. In the exercise of that authority a special resolution at a meeting of the shareholders or a resolution of the Board of directors should be passed. The amount involved in buy back should be less than 25% of the company's total paid up capital and free resources.[30] After the buy back, the ratio between the debts owed by the company should not be more than twice the capital and free resources of the company.[31] The shares to be bought back should be fully paid. The buy back should be in accordance with the regulations made by the Securities and Exchange Board of India. This requirement applies to listed securities. In the case of other securities, the buy-back has to be in accordance with guidelines as may be prescribed.

An amendment introduced in 2001[32] provides an exception to the operation of sub-section (2). The requirement of the sub-section is not to apply

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Brady v *Brady*, [1988] 2 All ER 617 HL, which examines the extent to which financial assistance can be provided in good faith for the larger interests of the company. Sub-section (5) provides that the section shall not affect the right of a company to redeem any shares issued under S. 80. Sub-section (4) provides penalty for default to the company as well as the officers in default.

30 A proviso adds that the buy-back of equity shares in any financial year shall not exceed 25% of the company's total paid-up equity capital in that financial year.

31 A proviso adds that the Central Government may prescribe a higher ratio of the debt than specified under this clause for a class or classes of Companies Debt means secured unsecured debts.

32 Companies (Amendment) Act, 2001, w.e.f. 23-10-2001.

where the buy-back is 10%, or less than that, of the total paid-up equity capital and free reserves of the company and has been authorised by a resolution of the Board of directors passed at its meetings. No offer of buy-back can be made within one year (365 days) reckoned from the date of the preceding offer of buy-back.

The section permits shares and other specified securities[33] to be bought back. The *Explanation* to sub-section (2) says that "specified securities" would include employees' stock option or other securities as may be notified by the Central Government from time to time.

The notice for convening the meeting of shareholders for passing a special resolution should carry the information prescribed by sub-section (3). The information is (*a*) a full and complete disclosure of all material facts; (*b*) the necessity for the buy-back; (*c*) the class of security intended to be purchased; (*d*) the amount to be invested in buy-back; (*e*) the amount involved and (*f*) time-limit for completion of the transaction. This is subject to the restriction set out in sub-section (4) that every such transaction must be completed within 12 months from the date of the special resolution.

The power may be exercised in buying back the shares from the existing shareholders of the company directly or from the open market or from odd lots[34] or from the employees' stock option shares or sweat equity shares.[35]

Declaration of solvency [sub-section (6)]

A declaration of solvency has to be filed with the Registrar and SEBI. This has to be filed before the resolution for buying back is implemented. It has to state that the Board of directors has made a full inquiry into the affairs of the company and have found that it is capable of meeting all its liabilities and will not be rendered insolvent for a period of 12 months from the date of the declaration. It has to be on a prescribed form and verified by an affidavit. It has be to be signed by at least two directors of the company, one of whom should be the managing director, if any. A company whose shares are not listed at a stock exchange has not to file this declaration with SEBI.

Physical destruction of securities [S. 77-A(7)]

Where a company has bought back its securities, it has to extinguish them and physically destroy them. This should be done within 7 days of the last day on which the buy-back process is completed.

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33 Which may be specified by the Central Government from time to time.

34 Which means the lot of securities in a listed public company which is smaller than the number of shares which can traded in a particular stock exchange in one transaction. Where the resolution for purchasing the shares of the company in the market did not satisfy the statutory requirements, it was held that the resolution was not of binding nature and was not enforceable against the company or against any one else, *Vision Express (UK) Ltd* v *Wilson (No 2)*, (1998) BCC 173; *Western* v *Righlast Holdings Ltd*, (1989) GWD 23-950 (Scotland). A defective resolution can be rectified before implementation but not afterwards, *R. W. Peak (King Lynn) Ltd, Re*, [1998] BCLC 193: [1998] BCC 596.

35 For meaning of sweat equity *see* S. 79-A.

Further issue after buy-back [S. 77-A(8)]

Where a company has resorted to the buying back of its securities, it cannot make a further issue of securities within a period of six[36] months. It may, however, make a bonus issue and discharge its existing obligations such as conversion of warrants, stock option schemes, sweat equity or conversion of preference shares or debentures into equity shares. This restriction applies only to the type of securities bought back. The company is free to issue other types of security.

Register of bought back securities [S. 77-A(9)]

A register has to be maintained containing the particulars of the bought back securities, including the consideration paid for them, the date of cancellation and such other particulars as may be prescribed.

Return of buy-back [S. 77-A(10)

After completing the process of buy-back, the company has to file a return with SEBI and Registrar. The return has to contain the prescribed particulars. It should be filed within 30 days from the date of completion.

Penalty [S. 77-A(11)]

A default in complying with the requirements of the section and rules made under it has been made a punishable offence. The company and every officer of the company who is in default will have to face an imprisonment which may extend up to two years or also fine which may extend to Rs 50,000 or both.

Transfer of money to Capital Redemption Reserves Account [S. 77-AA]

Where a company purchases its own shares out of free reserves, then a sum equal to the nominal value of the shares purchased has to be transferred to the Capital Redemption Reserve Account and its details have to be disclosed in the balance-sheet.

Prohibition of buy back in certain circumstances [S. 77-B]

A buy- back exercise has to be done directly and not through the medium of other companies. The section says that buy-back shall not be done through any subsidiary company including the company's own subsidiaries. It should also not be done through any investment company or a group of investment companies. A company shall not resort to buy-back if it is in default in payment of deposits, redemption of debentures or preference shares or repayment of a term loan to any financial institution or a bank.

No company is allowed to purchase its own shares directly or indirectly if the company has not complied with the provisions of Section 159 (annual return), Section 207 (default in paying declared dividend) and Section 211 (filing of annual report or accounts).

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36 *Substituted* for 24 months by the amendment of 2001.