

(1982) 12 BOM CK 0003

In the Bombay High Court

Case No : Appeal No. 42 of 1979 in Suit No. 487 of 1972 and Appeal No. 136 of 1979 in Suit No. 173 of 1974

Dahiben Umedbhai Patel and others

APPELLANT

Vs

Norman James Hamilton and others

RESPONDENT

Date of Decision : 08-12-1982

Acts Referred:

Companies Act, 1956 — Section 3

Securities Contracts (Regulation) Act, 1956 — Section 13, 14, 15, 16, 18

Citation : (1983) 85 BOMLR 275 : (1985) 57 CompCas 700

Hon'ble Judges : M.N. Chandurkar, J;B. Lentin, J

Bench : Division Bench

Judgement

Chandurkar, J.—This is an appeal by original defendants Nos. 2 to 5 against a decree for Rs. 73,041 with interest on the principal amount of Rs. 53,500 passed by the learned single judge in Summary Suit No. 487 of 1972 Norman J. Hamilton v. Umedbhai S. Patel [1979] 49 Comp Cas 1 (SC).

2. The facts in this appeal are not in dispute. The plaintiffs-respondents entered into an agreement with original defendants Nos. 1 to 4 to sell to original defendant No. 1 and defendants Nos. 2 to 4 and these defendants agreed to purchase from the plaintiffs 875 ordinary shares and 1,780 redeemable cumulative preference shares of a company known as A. Mac Rae & Co. Pvt. Ltd. for a total price of Rs. 3,10,000. Out of these shares, 125 ordinary shares and 520 redeemable cumulative preference shares belonged to one Mrs. Khambatta, who was a non-resident. It was, therefore, agreed between the parties that if there was any difficulty in the sale of the shares belonging to Mrs. Khambatta, defendants Nos. 1 to 4 would purchase in any event 875 ordinary shares and 1,780 redeemable cumulative preference shares of the company from the plaintiffs for a price of Rs. 2,77,500. Out of this purchase price, Rs. 10,000 were to be paid on the signing of the agreement and the balance of Rs. 2,67,500 was to be paid by 10 equal annual instalments of Rs. 26,750. The first of such instalments was to be paid on or before December 31, 1967, and the subsequent

instalments were to be paid on or before 31st December of each succeeding year. The fifth defendant guaranteed the above payments to the plaintiffs.

3. The plaintiffs accordingly sold and delivered to defendants Nos. 1 to 4,875 ordinary shares and 1,780 redeemable cumulative preference shares of A. Mac Rae & Co. Pvt. Ltd. and a sum of Rs. 10,000 was paid by the defendants to the plaintiffs on the signing of the agreement. The defendants, however, did not pay any of the annual instalments and the plaintiffs, therefore, filed to suit to recover the amount of the fourth and the fifth instalments.

4. The claim was contested by the defendants on the ground that when the agreement was entered into, the plaintiffs had represented to the defendants that there was no existing liability of the company but that, after the purchase of the shares, the defendants had received notices from third parties as well as from the sales tax and Income Tax authorities making large claims against the company for taxes and penalties for period prior to 1966. The total demand made by the Income Tax authorities, according to the defendants was for Rs. 8,63,509 by a demand notice dated February 14, 1975. It was also the case of the defendants that in or about December, 1966, the sales tax authorities had seized the books of the company and had made large demands amounting to several lakhs of rupees on account of the sales tax dues for period prior to the sale of the said shares. The defendants, therefore, claimed that they had damages to the extent of at least the entire purchase price of the shares and having regard to the provisions of s. 59 of the Sale of Goods Act, 1930, the entire price is extinguished. An additional ground on which the claim of the plaintiffs was contested was that the contract for the purchase of shares was illegal and could not be enforced having regard to the provisions of the Securities Contract (Regulation) Act, 1956 (hereinafter referred to as "the Regulation Act").

5. The learned single judge held that cl. 6 of the agreement dated December 23, 1966, in which the vendors had declared that there was no debt or liability due by the company and that in the event of its being established that any debt or liability was due by the company on the date of the agreement which the company was liable to pay, the vendors would personally pay the same, provided for a remedy for a breach of the stipulation that was laid down therein and the remedy of the company was to sue on the indemnity which was given by the plaintiffs under that clause. With regard to the claim of the defendants, that they had suffered damages the learned judge held that such a claim had to be pleaded by way of a set-off and no quantum of damages having been specified by the defendants, it would not be possible for them to rely on their claim for damages in diminution or extinction of the plaintiffs' claim for price. The learned judge thus held that a mere mention in the written statement that the defendants had suffered damages cannot be availed of by the defendants to claim extinction of price. The learned judge decided against the defendants issues Nos. 1 to 4 which dealt with the question of alleged misrepresentations made by the plaintiffs to the defendants.

6. The main issue which fell for consideration before the learned judge was issue No. 6, namely, "Whether the said agreement is illegal and void as claimed in para. 3 of the written statement ?" The agreement was alleged to be void as being in contravention of the provisions of s. 13 of the Regulation Act and the defendants further case was that the contract in question was not a "spot delivery contract" as defined in s. 2(i) of the Regulation Act and was, therefore, not exempt from the operation of s. 13 of the Regulation Act. The learned judge, on a careful scrutiny and analysis of the provisions of the Regulation Act, held that the shares of a private limited company were not marketable securities as defined in section 2(h) of the Regulation Act. The learned judge found that a marketable security is one which enjoys a high degree of liquidity and must, therefore, be such that it can be readily sold in the market. The learned judge took the view that the shares of a private limited company cannot be sold in the market and a reading of the definition of "security" (s. 2(h)) along with the definition of "stock exchange" (s. 2(j)) in the Regulation Act made it clear that the purpose of the Act was to control securities which were normally dealt with on the stock exchange, that is to say, shares of a public limited company. The learned judge referred to the Rules of the Bombay Stock Exchange which indicated, according to the learned judge, that the shares of a private limited company cannot be listed on the stock exchange because one of the basic requirements for listing of shares on the stock exchange is that they should be freely transferable. The learned judge suffered extensively to the background in which the Act was passed as indicated in the report of what was known as Gorwalla Committee. Having taken the view that the scheme of the Regulation Act was not intended to apply to the shares of a private limited company, the learned judge held that the transaction in question was not illegal. Consequently, the plaintiffs' suit was decreed.

7. At the outset, it has to be stated that though the learned counsel appearing on behalf of the defendants made an attempt to challenge the findings recorded on issues Nos. 1 to 5, it was not possible for the learned counsel to dispute that any claim for damages made by the defendants had to be specifically pleaded by way of set-off. Admittedly, no particulars of damages had been given by the defendants and though at one stage it was argued on behalf of the defendants that the defendants would have led evidence to prove the damages, it is obvious that such a course would have been wholly impermissible because not only was any set-off not pleaded, but even particulars of the alleged damages were not given and in view of these facts, a challenge to the finding on issues Nos. 1 to 5 must be negated and the findings recorded by the learned judge on those issues will have to be upheld.

8. The main argument in the appeal has really turned on issue No. 6 and the question which has been extensively argued by Mr. Mody on behalf of the appellants was that the transaction in question must be held to be illegal having regard to the provisions of s. 13 of the Regulation Act. Since a similar question was also involved in Appeal Nos. 136 of 1979 Dossabhai Gangjee & Co. Pvt. Ltd.

v. Surat Textile Mills Ltd., we have permitted the counsel appearing for the appellants and the respondents in that appeal to intervene because any decision in this appeal was likely to affect the decision in that appeal. Mr. M. H. Shah, appeared for the appellants, in Appeal No. 136 of 1979. Mr. B. R. Zaiwala, who appeared for the respondents in that appeal, wholly supported and adopted the arguments of the counsel for the respondents in the present appeal.

9. Now, before we refers to the arguments of Mr. Mody and Mr. Shah, which turned on the provisions of the Regulation Act, it is necessary to refer to certain provisions of that Act. The preamble of the Regulation Act states that it is "An Act to prevent undesirable transactions in securities by regulating the business of dealing therein, by prohibiting options and by providing for certain other matters connected therewith". As the Statement of Objects and reasons shows, the object of the Act was to provide for the regulation of stock Exchanges and of transactions in securities dealt in on them with a view to preventing undesirable speculation in them and it also seeks to regulate the buying and selling of securities outside the limits of stock exchanges through the licensing of security dealers. The regulation of stock exchanges and of transactions in securities dealt in on the stock exchanges is achieved by : (1) the prior recognition of stock exchanges subject to fulfilment by the stock exchanges of certain conditions relating to their membership and their rules and bye-laws, and (2) a general control over their trading methods and practices to be exercised through the powers conferred on the Central Govt. to approve their rules, regulations and bye-laws and to make or amend them. The recantation of stock exchanges and the withdrawal of recognition is dealt with by ss. 3, 4 and 5 and the control of the Central Govt. over the stock exchange is exercised by exercising powers given to the Central Government under ss. 8, 9, 10, 11 and 12, of the Regulation Act. A "recognised stock exchange" under s. 2(f) means a stock exchange which is for the time being recognised by the Central Government under s. 4. The most important definition which is relevant for the purpose of this appeal is the definition of "securities". Section 2(h) of the Regulation Act reads as follows :

"2(h) "securities" include -

- (i) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;
- (ii) Government securities; and
- (iii) rights or interests in securities".

10. We need not reproduce the definition of "spot delivery contract" (s. 2(i)) because it is not the case of the plaintiffs that the contract in question is a spot delivery contract which is exempted from the provisions of ss. 13, 14, 15 and 17 by s. 18 of the Regulation Act. As already pointed out, the main argument of the defendants is that the contract is hit by s. 13, while the argument of the learned counsel for the defendants is that the Regulation Act is wholly inapplicable in the

case of shares of a private company and, consequently, s. 13 does not in any way affect the plaintiffs claim.

11. The other provisions which must now be reproduced is s. 13 which reads as follows :

"If the Central Government is satisfied, having regard to the nature or the volume of transactions in securities in any State or area, that it is necessary so to do, it may, by notification in the Official Gazette, declare this section to apply to such State or area, and thereupon every contract in such State or area which is entered into after the date of the notification otherwise than between members of a recognised stock exchange in such State or area or through or with such member shall be illegal."

12. There is no doubt that the provisions of s. 13 have been made applicable by the Central Government to Greater Bombay.

13. Mr. Mody appearing on behalf of the appellants has contended, as was contended before the learned single judge, that all shares which can be sold, whether by a private treaty or through the stock exchange or in any other manner, should be considered as marketable securities and the word "marketable" in the definition of "securities" should be construed as meaning only "saleable". According to the learned counsel, the Act was enacted to regulate contracts in respect of securities and there was nothing in the Act to indicate that the Legislature intended to control only some contracts. The learned counsel also contended that s. 2(h)(i) contained the words "any incorporated company or other body corporate" and these words must be interpreted as to take in even a private company. The learned counsel pointed out that the concepts of both private and public companies were quite well known and the Legislature must be presumed to have known those concepts and yet, while defining "securities", the words used were "incorporated company" and not a "public company". It was urged that the use of the word "marketable" in the definition of "securities" did not contemplate existence of a market place. Reference was also made to s. 21 of the Act which provides for a power of the central Government to comply listing of securities by public companies. It was urged that when the Legislature wanted to refer to public companies specifically, such reference has been made and since in the definition of "securities", the reference is to an incorporated company, that cannot be construed as referring only to a public company. Reference was also made to the rule-making power of the Central Government which in s. 30(2)(h) provides that rules could be made providing for the requirements which shall be complied with by public companies for the purpose of getting their securities listed on any stock exchange.

14. Mr. Shah, who also contended for a construction as the one for which Mr. Mody argued, has argued that the regulation Act is of general application and does not apply only to some companies and, according to the learned counsel, there was no warrant for excluding the shares of a private limited company from

the operation of the Act and such an attempt, according to the learned counsel, would amount to addition of words in the definition of "securities". Mr. Shah argued that ss. 13, 16 and 17 were applicable to all companies and he also made a reference to the provisions of s. 21 of the Regulation Act. According to Mr. Shah, while reading the definition of "securities", the principle of *noscitur a sociis* could not be invoked in the present case and the object of making the definition of "securities", inclusive was to give it a very wide meaning and it was, therefore, wholly unnecessary to take recourse to any rules of interpretation.

15. Mr. Parekh appearing on behalf of the respondents has supported the view taken by the learned single judge and, according to him, shares of a private company cannot be said to be marketable because marketability must mean that the shares are saleable by any one to any one at a normalised market, while the shares of a private limited company are not freely transferable and reference was made to the restrictions which were sometimes placed on a transfer of shares of a private limited company such as rights of pre-emption and reference was made to The Encyclopaedia of Forms and Precedents, fourth edition, volume 5, pages 342 and 370, which contain specimen articles of association of a private limited company. Mr. Parekh dealt extensively with the provisions of the Act and pointed that the rules made under the Act and the provisions in the bye-laws of the Bombay Stock Exchange clearly show that the shares of a private limited company could not be bought and sold as a matter of right in the market provided by the stock exchange. Some reference was also made to the definition of "marketable security" (s. 2(16A)) in the Indian Stamp Act, 1899, which defines "marketable security" as meaning a security of such a description as to be capable of being sold in any stock market.

16. Now, as the preamble of the Act shows, it was enacted, *inter alia*, to prevent undesirable transactions in securities by regulating the business of dealing therein. The preamble clearly indicates that what was intended to be done by the enactment was to regulate the business of dealing in securities. It is obvious that there was business carried on by people consisting of buying and selling of securities and that in the course of such business, there were undesirable transactions in securities which had to be controlled. It would be permissible to look into the evil to remedy which the legislation was intended and the conditions prevalent prior to the enactment of the Regulation Act can certainly be referred to for the purpose of construing the provisions of law. So far as Bombay was concerned, trading in securities was controlled by the Bombay Securities Contracts Control Act, 1925, which was enacted to regulate and control certain contracts for the purchase and sale of securities in the City of Bombay and elsewhere in the Bombay Presidency. Under that Act, "securities" included stocks, shares, bonds, debentures, debenture stock and any other instrument of a like nature. The "stock exchange" was defined as meaning "any association, organisation or body of individuals, whether incorporated or not, established for the purpose of assisting, regulating and controlling business in buying selling and dealing in stocks, shares, bonds, debentures, debenture stock and any other like

securities". Section 4 of that Act required a stock exchange to be recognised by the Governor-in-Council and the stock exchange had to submit rules for the regulation and control of transaction in securities other than ready to delivery contracts and furnish such information in regard to such recognition as the Governor-in-Council may require. Section 6 of that Act required that every contract for the purchase or sale of securities, other than a ready delivery contract, entered into after a date to be notified in this behalf by the Governor-in-Council shall be void unless the same is made subject to and in accordance with the rules duly sanctioned under s. 4 and every such contract shall be void unless the same is made between members or through a member of a recognised stock exchange; and no claim shall be allowed to any civil court for the recovery of any commission, brokerage, fee or reward in respect of any such contract. This is a provision which is very similar to s. 13 of the Regulation Act. It was, however, found that the impacts of this Act on the regulation of trading in securities was not significant. Huge losses suffered by the investing public during 1928 to 1938 brought forth public criticism and the Government of Bombay appointed a committee called Morrison Committee in 1936. Recommendations made by this committee were not found to be useful. The Government of India had appointed a committee in May 1948, headed by Dr. P. J Thomas, Economic adviser to the Ministry of Finance, to submit a report or a suitable law to regulate the stock exchange in India. Later on in 1951, a draft Bill on stock exchange regulation was prepared by the Government and this Bill was referred to an expert committee under the chairmanship of Mr. A. D. Gorwalla. The present Act is a result of the recommendations of the Gorwalla Committee which were formulated in the form of Securities Contracts (Regulation) Bill, 1954. One of the terms of reference of the committee was to consider draft proposals of the Government on the subject of stock exchange regulation.

17. Now, s. 4 of the Regulation Act provides for grant of recognition to stock exchanges. Before granting recognition, the Central Government is to be satisfied that the rules and bye-laws of a stock exchange applying for registration are in conformity with such conditions as have been prescribed with a view to ensure fair dealings and to protect investors and no rules of a recognised stock exchange can be amended except with the approval of the Central Government. There is power in s. 8 of the Regulation Act to require a stock exchange to make rules or amend any rules in respect of the matters specified in s. 3(2) of the Regulation Act. The nature of the bye-laws which the recognised stock exchanges can make is regulated by s. 9 of the Act and there is power under s. 10 in the Central Government to make or amend bye-laws of recognised stock exchange.

18. The bye-laws required to be made by a recognised stock exchange have to be in respect of matters prescribed in s. 9(2) and one of the items in s. 9(2) is "the opening and closing of markets and the regulation of the hours of trade". Rule 19 of the Securities Contracts (Regulation) Rules, 1957 (hereinafter referred to as "the Rules"), provides for requirements with respect to the listing of securities on a recognised stock exchange. Rule 19(2) of the Rules provides that

apart from complying with such other terms and conditions as may be laid down by a recognised stock exchange, an applicant, that is, a public company, as defined under the Companies Act, 1956, which is desirous of getting its securities listed on a recognised stock exchange and which has applied for that purpose to the stock exchange has to satisfy the stock exchange that at least 60% of each class or kind of securities issued by the company was offered to the public for subscription through advertisement in newspapers for a period of not less than three days and that applications received in pursuance of such offer were allotted fairly and unconditionally. This requirement can no doubt be relaxed under the proviso to rule 19(2) (b) with the previous approval of the Central Government on satisfactory evidence being produced by the company concerned that the securities sought to be listed are not unduly concentrated in a few hands. The provisions relating to the recognition of stock exchange and the rules made under the Regulation Act along with the nature of the bye-laws that are contemplated by the Regulation Act clearly indicate that a stock exchange provides for a market for buying and selling of securities. As observed in Palmer's Company Law, volume II, 22nd edition, Part C, at page 4005 :

"The stock exchange provides a market for the purchase and sale of securities. The efficient operation of such a market depends primarily upon adequacy of information, a quantity of securities whose distribution is sufficiently wide to provide marketability and certainly of procedures for the settlement of business."

19. Thus, if stock exchange is the market where securities are bought and sold and the transactions in securities are intended to be controlled by regulating the business of dealing in these securities, the provisions of the Regulation Act must be read in the light of these facts. It can hardly be disputed that the object of s. 13 is to make illegal a transaction in securities in an area to which s. 13 has been made applicable if such a transaction is entered into thereafter otherwise than between the members of a recognised stock exchange or through or with such member. The effect of this provision clearly is that if a transaction in securities has to be validly entered into, such a transaction has to be either between the members of a recognised stock exchange or through a member of a stock exchange or with a member of a recognised stock exchange.

20. Throughout the Act, the reference has been made to a transaction in "securities" and we must, therefore, go back to the definition of "securities" which we have reproduced above. Now, it is implicit that so far as the listing of securities on the stock exchange is concerned, such listing can be only of securities of a public company because one of the requirements in rule 19(2) (b) is that at least 60% of each class or kind of securities issued by the company was offered to the public for subscription. "Securities" has been defined, as already pointed out, by way of an inclusive definition. Now, it is important to bear in mind that the inclusive definition, in so far as it is relevant, refers to shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body

corporate. It is true that if the words "in or of any incorporated company" are taken by themselves out of context in which they are used in the definition of securities, there will be no reason to exclude a private company out of those words because a private company is also an incorporated company. Unfortunately for the appellants, however, those words have to be read along with the words preceding them. It is there that it is contended that the shares of a private company must also be regarded as a marketable security and that "marketable" must be understood as being synonymous with saleable. The argument is that the share of a private company is a saleable security; it is, therefore, a marketable security of an incorporated company, that is, a private company and, consequently, a transaction of sale of a share of a private company, if it is entered into otherwise than between members of a recognised stock exchange or through or with such member is illegal in view of the provisions of s. 13 of the Regulation Act. It is not in dispute that the transaction in question does not satisfy requirements of the validity prescribed in s. 13. The contention of Mr. Parakh is that having regard to the use of the words "other marketable securities of a like nature", marketability must be a requirement which must be applicable to all the categories enumerated earlier and that so far as the Regulation Act is concerned, it deals only with marketable securities and having regard to the absence of free transferability in the case of shares of a private company, those shares cannot be said to be marketable securities as defined under the Act and, consequently, there was no question of a transaction becoming bad by virtue of s. 13 of the Regulation Act.

21. Now, it is difficult for us to accept the argument of the appellants that the definition of "securities" must be so read that the words "other remarkable securities of a like nature" were not intended to indicate an element of marketability in so far as the preceding categories were concerned. A reading of the inclusive part of the definition shows that the Legislature has enumerated different kinds of securities and by way of a residuary clause used the words "or other marketable securities of a like nature". The use of these words was clearly intended to mean that the earlier categories of securities had to be marketable and any other securities of "like nature", that is to say, like those which were categorised or enumerated earlier were also to be marketable before they could be held to fall within the definition of "securities".

22. It is no doubt true that some reference was made on behalf of the respondents before us to the doctrine *noscitur a sociis* which means that the meaning of a word is to be judged by the company it keeps. Dealing with this doctrine, the Supreme Court in *The State of Bombay and Others Vs. The Hospital Mazdoor Sabha and Others*, pointed out that *noscitur a sociis* is merely a rule of construction and it cannot prevail in cases where it is clear that the wider words have been deliberately used in order to make the scope of the defined word correspondingly wider and it is only where the intention of the Legislature in associating wider words with words of narrower significance is doubtful or otherwise not clear that the above rule of construction can be usefully applied.

The Supreme Court has also pointed out that where the object of the Legislature in using wider words is clear and free of ambiguity, the rule of construction in question cannot be pressed into service.

23. We do not think it is necessary for us to take recourse to this rule of construction because, in our view, the words plainly read as incapable of any other meaning except that the Legislature made the definition of "securities" an inclusive one having regard to the object with which the Regulation Act was enacted, namely, to control transactions which were carried on in market, that is, the stock exchange. The securities referred to in the definition were clearly intended to have a character of marketability. It is no doubt true that what is saleable can also be marketable. But when you are dealing with a market where transactions in only a particular commodity are carried on, then the marketability of securities must be considered from that angle. It is needless to point out that a market contemplates an appointed place of buying and selling. Indeed, the Act itself refers to the power of the stock exchange to provide for opening and closing of markets and the regulation of the hours of trade as a matter on which a bye-law can be made by the stock exchange. The stock exchange, therefore, is contemplated as a market even under the Act.

24. We may, however, make a reference to the decision of the House of Lords in *Rye v. Rye* [1962] AC 496. The relevant provision, which fell for consideration in that case, was s. 205(1) of the Law of Property Act, 1925. The relevant part of the provision read as follows :

"205 (1). In this Act, unless the context otherwise requires, the following expressions have the meaning hereby assigned to them

(ii) "Conveyance" includes a mortgage, charge, lease, assent, vesting declaration, vesting instrument, disclaimer, release and every other assurance of property or of an interest therein by any instrument"

25. The question which fell for decision in that case was whether an oral lease amounted to a conveyance as defined in the Act. It was held in that case that an oral tenancy is not a lease within the definition of s. 205(1) and, therefore, the alleged oral letting, in that case, was not a conveyance for the purposes of s. 72 of the Law of Property Act and was without legal effect. Lord Mac Dermott, after referring to the definition of "conveyance" observed as follows (p. 507);

"Though Buckley, J. took a different view, I respectfully agree with the Court of Appeal that, in construing this definition, the words "and every other assurance ... by any instrument" cannot be related solely to the word "release" and must be read as referring also to the earlier words, including "lease", so as to make of them a catalogue of instruments. In this context "instrument" must not be a document, and I, therefore, conclude that an oral tenancy will not be a "lease" within the definition and, therefore, will not be a "conveyance" for the purposes of section 72, unless it can be brought in by the word "includes" or by the expression "the context otherwise requires"."

26. Lord Radcliffe, in the same case, observed as follows (p. 511) :

"Section 205 is explicitly an interpretation section and, even though the word "include" is used, "convey" is there defined, unless a particular context extends or reduces its meaning. I construe section 205 (1) (ii) as confining its definition to written instruments by virtue of the words "every other assurance of property by any instrument" in writing. That is what I should expect, for by 1925 the very idea of an oral conveyance seems to me anomalous. There is a known ambiguity in such words as "conveyance", since by themselves they are capable of referring either to the transaction itself or to the legal instrument that effect it. This is true of "conveyance", "mortgage", or "lease", but it is not true of "vesting declaration", which can refer only to the instrument itself : and when I find these and other words linked together in a definition of the word "conveyance" with a general reference at the end of the list to "every other assurance by any instrument" in writing, I feel little doubt that, apart from any special contexts, "conveyance" and "convey" in the Act are intended to apply to instruments in writing only."

27. Thus, as put by Lord Mac Dermott, the word "marketable" must, in the present case, govern the catalogue of securities earlier mentioned.

28. In Webster's Third New International Dictionary, "marketable" is stated to mean "fit to be offered for sale in a market; being such as may be justly or lawfully sold or bought". In order that securities may be marketable in the market, namely, the stock exchange, the shares of a company must be capable of being sold and purchased without any restrictions. In other words, the transfer of a share in a company must vest title in the purchaser and this vesting of title in the purchaser should not be made to depend on any other circumstance except the circumstance of sale and purchase. A market, therefore, contemplates a free transaction where shares can be sold and purchased without any restriction as to title. The shares which are sold in a market must, therefore, have a high degree of liquidity by virtue of their character of free transferability. Such character of free transferability is to be found in the shares of a public company. The definition of a "private company" in s. 3 of the Companies Act, 1956, speaks of the restrictions for which the articles of the private company must provide. The articles of a private company must :

"3(1)(iii)(a) restricts the right to transfer its shares, if any;

(b) limits the number of its members to 50 not including -

(i) persons who are in the employment of the company, and

(ii) persons who, having been formerly in the employment of the company, were members of the company while in that employment and have continued to be members after the employment ceased; and

(c) prohibits any invitation to the public to subscribe for any shares in or debentures of, a company."

29. The restriction with regard to the transfer of the shares is a characteristic of a private company. These restrictions with regard to transfer of shares may take various forms and in this context, we may refer to the model articles of association of a private company from the Encyclopaedia of Forms and Precedents Volume 5, fourth edition. One of the articles of a private company can be as follows :

"The directors may decline to register the transfer of share (not being a fully paid share) to a person of whom they shall not approve, and they may also decline to register the transfer of a share on which the company has lien". (article 24, page 302).

30. The other nature of a restriction on a transfer is to be found in article 8 at page 342. Under that article, a member desiring to transfer any share has to give to the company a notice in writing of such desire and once such notice is given, the company becomes the agent of the vendor for the sale of the shares at the discretion of the directors to the members other than the vendor at a price to be agreed upon by the vendor and the directors, in case of difference, at the price which the auditor of the company for the time being shall certify to be, in his opinion, the fair value thereof as between a willing seller and a willing buyer. The article also provides that upon the price being fixed to the auditor, the company shall forthwith by notice in writing inform each member other than the vendor of the number and price of the said shares and invite each such member to apply in writing to the company within the fixed period for such number of shares as he may specify in the application. Thus, in the case of a private company, there is a very wide discretion which is vested in the directors in the matter of registration of transfer of its shares. As a matter of fact, if a transfer is in breach of the articles, as reproduced above, the transfer is ineffective and does not transfer even equitable interest, as will be clear from the decision of the House of Lords in *Hunter v. Hunter* [1936] AC 222.

31. Dealing with restrictions on transfer in private companies, it is observed in *Palmer's Company Law*, 22nd edition, vol. I at p. 393, para 40-12 as follows :

"A private company is normally what the Americans call a "close corporation"; this means that its members are connected by bonds of kinship, friendship or similar close ties and that the intrusion of a stranger as a shareholder would be felt to be undesirable unless his admission is accepted by those for the time being interested in the company. Some private companies are in fact so constructed as to amount in economic terms to incorporated partnership with the attendant close connection between the members."

32. The learned author has also pointed out that "Where a discretion as to registering transfers is given by the articles to the directors, the court will not control the exercise of this discretion, unless it is proved that the directors are not exercising it bona fide; in other words, that they are acting oppressively, capriciously, or corruptly or in some way mala fide." (page 396).

33. The learned author at page 398 has observed :

"Restrictions on the right of transfer may restrict a mortgagee's power of sale over the shares since he can have no right of transfer that is forbidden to members. Registration by the secretary without the authority of the directors can be repudiated by them."

34. Dealing with transferability of shares, it is observed in Gore-Borwne on Companies, Chapter 16, para. 16-2 as follows :

"Subject to certain limited restrictions imposed by law, a shareholder has prima facie the right to transfer his shares when and to whom he pleases. This freedom to transfer may, however, be significantly curtailed by provisions in the articles. Restricting provisions are legal and, indeed, the mandatory in the case of private companies; on the other hand the stock exchanges require that the transfer of full paid quoted shares should not be restricted by the articles in any way."

35. The learned author has pointed out that if shares are sold in contravention of a pre-emption clause, there is no transfer of the legal title while the vendor remains on the register and a person who is entitled under the pre-emption clause to have the shares first offered to him can sue to have the register rectified by insertion of his name as legal holder. (Chapter 16, (16.4))

36. It is thus clear that the shares of a private company do not possess the character of liquidity, which means that the purchaser of shares cannot be guaranteed that he will be registered as a member of the company. Such shares cannot be sold in the market or in other words, they cannot be said to be marketable and cannot, therefore, be said to fall within the definition of "securities" as a "marketable security". On the other hand, in the case of a sale of share of a public company, the transfer is completed and even if the transfer is not registered, the transferor holds the shares for the benefit of the transferee. In Mathalone Vs. Bombay Life Assurance Co. Ltd., dealing with the rights of a transferee of shares of a public company, the Supreme Court has pointed out the to on the transfer of shares, the transferee becomes the sole beneficial owner of those shares sold by the transferor, the legal title to which is vested in him and the transferor holds the shares for the benefit of the transferee to the extent necessary to satisfy the elements of s. 94 of the India trusts Act 1882. It was held that the transferor becomes a trustee of dividends as the transferee holds the beneficial interest and the transferor is also a trustee of the right to vote because the right to vote is a right to property annexed to the shares and, as such, the beneficiary has a right to control the exercise by the trustee of the right to vote. It is pointed out that the relationship of trustee and cestui que trust arises by reason of the circumstance that till the name of the transferee is brought on the register of shareholders in order to bring about a fair dealing between the transferor and the transferee, equity clothes the transferor with the status of a constructive trustee and this obliges him to transfer all the benefits of property rights annexed to the sold shares of the cestui que trust.

37. It is thus clear to us that the definition of "securities" will only take in shares of a public limited company notwithstanding the use of the words "any incorporated company or other body corporate" in the definition.

38. The reference to public companies in s. 21 of the Regulation Act cannot be of any assistance to the appellants. Acceptance of the argument advanced by the learned counsel for the appellants that the definition of securities should be held to include shares of a private limited company because Government has expressly taken the power to compel listing of "securities" by public companies would mean that while the object of the legislation was expressly to control transactions in securities, which, according to the learned counsel for the appellants, would also mean transaction in shares of private companies, the Government would have no such control by forcing private companies to list their securities. As a matter of fact, one of the prescribed conditions for listing is that 60% of the shares of the company must be offered to the public. There is a choice to a company to list its shares and this choice will obviously be not available to a private company because it does not satisfy the required condition in r. 19 (2) (b). It would, therefore, not be possible to construe the definition "securities" by making a reference to the scope of the power under s. 21 of the Regulation Act.

39. As already pointed out, we are not concerned with the provisions of s. 18, nor with the provisions of ss. 14, 15 and 16. But it is enough to state that these provisions will not be of any assistance to the appellants because they again deal with securities as defined under the Act and if the definition of "securities" itself requires marketability as one of the essential conditions which, as we have pointed out, shares of a private company do not possess, the appellants cannot succeed in their contention that the contract in the instant case was void under s. 13.

40. It is true that by virtue of the powers conferred by s. 28(2) of the Regulation Act, the Central Government has by notification dated June 27, 1961, excluded from the operation of the Regulation Act contracts for pre-emption or similar rights contained in the pre-emption or collaboration agreements or in the articles of association of limited companies. It is, however, difficult to see what relevance this notification has because the Regulation Act itself has been made inapplicable to contracts for pre-emption or similar rights only in respect of promotion or collaboration agreement or where such contracts are contained in the articles of association. If the whole Act itself is inapplicable, then it is difficult to see how even on the contention of the appellants the provisions of s. 13 can be relied upon by the appellants.

41. Some reference was made before us to the Rules of the Bombay Stock Exchange. We do not think it necessary to refer to them because we have chosen to construe the definition of "securities" in the light of the provisions of the Regulation Act itself.

42. It is also not further necessary to rely on the definition of "marketable security" in the Indian Stamp Act for the purpose of construing the definition in the instant case.

43. Having regard to the view which we have taken, it is not possible for us to find any error in the view which the learned judge has taken that the present contract is not governed by the provisions of the Securities Contracts (Regulation) Act, 1956, and is, therefore, not illegal. Consequently, the appeal fails and is dismissed with costs.

44. Prayer for leave to appeal to the Supreme Court rejected.