

(2001) 02 AP CK 0066
In the Andhra Pradesh High Court
Case No : CA No 1 of 2001

Gothami Solvent Oils Limited, Pydiparu, Tanuku, W.G. District and Another APPELLANT

Vs

Mallina Bharathi Rao and Another RESPONDENT

Date of Decision : 26-02-2001

Acts Referred:

Civil Procedure Code, 1908 (CPC) — Order 21 Rule 80
Companies Act, 1913 — Section 34
Companies Act, 1956 — Section 108, 10F, 173(2), 176, 31
Constitution of India, 1950 — Article 13, 16C, 8
Contract Act, 1872 — Section 74

Citation : (2001) 2 ALD 516 : (2004) 7 ALT 470 : (2001) 105 CompCas 710

Hon'ble Judges : J. Chelameswar, J

Bench : Single Bench

Advocate : Mr. Ravi S, for the Appellant; Mr. V.S. Raju and Mr. A. Sanjay Kishore, for the Respondent

Judgement

1. Chelameswar, J.—This is an appeal preferred u/s 10-F of the Companies Act by the respondents in CP No.7/111/SRB/ 2000, dated 29-12-2000 on the of the Company Law Board, Southern Region Bench, Chennai.

2. The first respondent herein was the petitioner before the Company Law Board in the above mentioned company petition. She was a shareholder of the first appellant company herein holding (350) shares. The first appellant company was initially incorporated as a private limited company on the 22nd March, 1974. Subsequently, on 15th June, 1988 by virtue of the operation of the provisions u/s 43A of the Companies Act, the company became a public limited company.

3. Article 8 of the Articles of Association of the first appellant company imposes certain restrictions on the right of the shareholders to transfer the shares (the details of which may not be necessary for the purpose of this case), except noting that the right to transfer the shares is not absolute under the Articles of Association. Further Article 13 reads as follows:

"If in any case the Proposing Transferor, after having become bound as aforesaid, makes default in transferring the share the Company may receive the purchase money, and the Proposing Transferor shall be deemed to have appointed any one Director as his agent to execute a transfer of the share to the Purchasing Member or person selected as aforesaid, and upon the execution of such transfer the company shall hold the purchase money in trust for the Proposing Transferor. The receipt of the company for the purchase-money shall be a good discharge to the Purchasing Member or person selected as aforesaid and after his name has been entered in the register in purported exercise of the above power the validity of the proceedings shall not be questioned by any person."

4. On 30-10-1999, in an Extraordinary General Meeting of the company held at the registered office of the appellant company, the Articles of Association of the company were resolved to be amended; thereby the original Article 16 of the company was renumbered as Articles 16A and 16B and 16C were introduced. Accordingly, the amendments were effected and after the amendment the relevant articles read as follows:

"16-A The Board of Directors can, in the best interests of the company if they thought fit, refuse registration of any application for transfer. Without assigning any reason for so doing and they shall give notice of refusal in all such case within one month.

16-B. In the event of the 90 per cent shareholders in number and share capital so decide that a member shall cease to be a member by a special resolution in a General Body Meeting (Extraordinary/ Annual General Meeting), the membership of such shareholder shall stand cancelled immediately.

16-C. Immediately after passing of the resolution as stated in Article "16-B" such shareholder shall transfer his share to any another individual who is an existing member of the Company following the procedure laid down in Articles 9 to 13"

5. By a letter dated 11-12-1999 signed by the second appellant, herein on behalf of the first appellant, the first respondent was informed that by virtue of a resolution approved in an Extraordinary General Body Meeting held on 30-11-1999, the first respondent ceased to be a member of the company with effect from the said date and consequentially the first respondent's shares would be acquired by any one of the existing shareholders of the company as per the provisions of the Articles of Association. Therefore, the first respondent was called upon to surrender the share certificates and also indicate the price, which the first respondent considers to be the fair value of the shares and failure on the part of the first respondent to indicate the value of the shares would enable the first appellant herein to fix the fair market price of the shares in accordance with the procedure laid down in the Articles of Association. The first respondent by its letter dated 14-12-1999 protested against such communication indicating that he was not willing to transfer the shares and such a proposal for transfer of shares was illegal. Subsequently, by another communication-dated 9-2-2000 the first

appellant informed the first respondent as follows: (The relevant portion of the said letter reads as follows)

"This is to inform you that the Board of Directors by its resolution dated 8-2-2000 authorised Sri B. Sreemannarayana, a Director of the Company)o act as your agent and execute the transfer deed for the shares being held by you in favour of Sri M. Ramachandra Rao, the purchaser at the rate of Rs. 668/- per share as decided by the Board which is the book value per each share. In pursuance of that the transfer deed in executed by Sri B. Sreemannarayana and the transfer of the shares is effected in the company records in favour of Sri M. Ramachandra Rao. The total value of the shares of Rs.2,33,800/- was received by the company from Sri M. Ramachandra Rao and the same is herewith sent to you by way of a demand draft drawn on State Bank of India, Peddapuram bearing No.797999 for Rs.2,33,800/- (including bank commission) dated 9-2-2000.

We therefore request you to acknowledge the same immediately and further request you to surrender the share certificates."

6. In the explanatory statement as required u/s 173(2) of the Companies Act appended to the notice of the Extraordinary General Meeting held on 30th November, 1999 wherein the decision to cancel the membership of the first respondent was taken, reads as follows:

"1. The company was formed by a group of close relatives in the spirit of Partnership. However, the conduct of Mrs. Bharati Rao and her husband who is acting as the representative and proxy have been detrimental and injurious to the interests of the company. Despite repeated requests and cautioning they are continuing to harass the management and acting in a manner prejudicial and harmful to the interests of the Company.

2. Mrs. Bharati Rao and her husband Mr. Narasimha Rao made a number of baseless and frivolous complaints to various authorities such as Income Tax Department, Banks, Department of Company Affairs and Registrar of Companies merely with a view to hinder and obstruct the smooth day to day function of the company and harass the management and is dragging the company into unnecessary litigation. Some of the specific instances are as follows:

(a) They have written a letter to the Income Tax Department, Visakhapatnam making false allegation that the company's profits have been siphoned off and brought in as capital by members. The company has to defend itself.

(b) They have made repeated and baseless complaints to Department of Company Affairs and Registrar of companies alleging violation of various provisions of the Companies Act. The company has replied to the allegation and the matter are closed.

(c) They have made complaint to State Bank of India questioning the sanctioning of the term loan for the "Cogeneration Plant" which is contributing major profits

to the Company. The company has relied and the matter is closed.

(d) In addition to the above she made various complaints to Consumers Court etc., which have also been dismissed.

3. Her false and biased complaints are tarnishing the image of the company and lowering its image in the public besides creating unnecessary suspicions/doubts in the minds of the various authorities regarding bona fide transactions and business activities of the company. The acts of Mrs. Bharati Rao and her husband are detrimental and injurious to the interest of the company which is known for professional management and for promoting shareholders interest and value.

4. She and her husband acting on her behalf have obtained privileged business information of the company and technical details of its operations and other confidential information which they are passing on to your company's competitors in business where Mr. Narasimha Rao is working and their close relatives have majority stake.

5. She is repeatedly raising trivial issues and loudly protesting about the insignificant matters and requesting for all inconsequential information and details on regular basis, thereby distracting and diverting the attention, time and effort of the management away from the more important business activity of the company thereby causing loss to your company in terms of money, time and effort.

6. In the company's general meeting Mr. Narasimha Rao who has attended as the proxy of Mrs. Bharati Rao has raised frivolous and unconnected matters merely to disrupt the proceedings and hinder the company's work. This behaviour is in violation of the Section 176 of the Companies Act.

7. The affairs of your company which is a closely held one are being given bad publicity by her to outsiders who have no connections whatsoever with the company.

The management and the company have patiently endured all the troubles/problems and obstructions created by Mrs. Bharati Rao for the past few years in the hope that she would change and act as a responsible shareholder in the interest of the company. However the things are getting worse.

Hence the above Resolution."

7. Aggrieved by the action of the first appellant company in cancelling the membership and the consequential steps to have the shares of the first respondent transferred compulsorily in favour of one of the other shareholders, as described above, the first respondent approached the Company Law Board.

8. The Company Law Board allowed the company petition of the first respondent by its order dated 29-12-2000. The substance of the order is that the action of the appellants herein in transferring the shares of the first respondent is in contravention of the mandatory provisions of Section 108 of the Companies Act.

The consequent omission of the name of the first respondent from the register of the appellant company is without sufficient cause and therefore directed the first appellant to restore the name of the first respondent, on the Register of Members.

9. Learned Counsel for the appellant submitted that the decision of the Company Law Board is illegal as the Company Law Board misdirected itself on the real question involved in the case. The questions that the Company Law Board ought to have addressed itself are whether the first appellant company is legally entitled to amend the Articles of Association thereby providing the compulsory transfer of the shares of one of the shareholders in a manner as provided under the amended Article 16-A to C. Secondly, if the first appellant company has such a power to amend the Articles of Association as mentioned above, whether the power under the amended Articles of Association was exercised in accordance with Law and the amended Articles of Association and bona fide. The learned Counsel further argued that, the decision of the Company Law Board insofar as it held that the transfer of the shares of the first respondent effected without there being a valid instrument of transfer illegal, is unsustainable in law as the instrument of transfer is not required to be executed only by the first respondent-transferor. u/s 108 of the Companies Act such an instrument could be executed either "by or on behalf of the transferor". In the present case, since it was a case of compulsory transfer without the consent of the first respondent, she is not expected to execute such a valid instrument of transfer and therefore as authorised by the Articles of Association one of the directors executed the instrument of transfer.

10. On the other hand, the learned Counsel for the first respondent - Sri V.S. Raju, argued that the amendment of the Articles of Association is illegal - for the reasons that the first respondent's right to hold the shares is interfered with without any authority of law and assuming that the amendment such as the one made in the present case could be made by the company, such amendments were made behind the back of the first respondent i.e., without any notice to the first respondent and therefore the amendments do not bind the first respondent.

11. I must clear up one factual issue before I proceed to examine the questions of law. Though the question, that the amendments of the Articles of Association were made without a proper notice to the respondent, was raised before the Company Law Board, the Company Law Board did not record any finding on the same and I do not find any material on record to come to any conclusion on the question whether such a notice was given to the first respondent or not,

12. The Supreme Court in N.C, Sanyal v. Calcutta Stock Exchange Association Limited, 1971 Vol.41 Company Cases 51, held as follows:

"Subject to the provisions of the Companies Act, a company and its members were bound by the provisions contained in the Articles of Association. The articles regulated the internal management of the company and defines the powers of its

officers. They also establish a contract between the company and the members and the members inter se. The contract governed the ordinary rights and obligations incidental to membership in the company."

13. In view of the law declared by the Supreme Court the Article, of Association of the company are in the nature of a contract-though the exact nature of the contract is very difficult to define. See the opinion of Lord Sterndale MR in 1920 Ch.D. 154 at 162) between the company, and its shareholders and the members inter se, stipulating the terms which a person becomes a member of the company. In other words the rights and liabilities of the members of a company are regulated by the Articles of Association. Obviously, a person on becoming the member of the company, agrees to be bound by such a contract

14. But in the present case, the provision for compulsory transfer of shares of one of the members against the member's consent was not there originally in the Articles of Association; but included subsequently by an amendment of the Articles of Association. The alteration of the Articles of Association is permitted u/s 31 of the Companies Act. Subsection (1) of Section 31 reads as follows:

"Subject to the provisions of this Act and to the conditions contained in its memorandum, a company may, by special resolution, alter its Articles"

15. Sub-section (2) of Section 31 declares that the alteration so made shall be as valid as if originally contained in the Articles of Association subject, of course, to the provisions of the Companies Act. Therefore, the fact that the amended Articles 16-A to C provided for compulsory transfer of the shares against the wishes of some of the existing members of the company, in my view, does not make any difference insofar as its legality is concerned, if the company could provide such articles at the inception or prior to the entry of such of the members. The question is whether such a power to expel a member of the company can be conferred by the Articles of Association as originally framed?

16. It is no more *res Integra*. Lord Warrington J., in his concurring judgment in *Sidebottom v. Kershaw*, 1920 Ch. D 154 at 169 , held:

".....a power which is virtually a power to expel a member upon terms to get rid of a member as shareholderit is conceded and in fact it could not be contended otherwise, that such a power might be resorted in the Articles of Association as originally framed".

17. In a separate but concurring judgment Lord Warrington, J., observed:

".....that such a provision if inserted in the original articles would be valid follows from the decision in *Philips v. Manufacturers' Securities Limited* , 116 LT 290. "

18. Similarly, in *NC. Sanyal's case* (supra) the Supreme Court held valid a condition of the Articles of Association of the Calcutta Stock Exchange Association, which provided for the forfeiture of the shares of one of the members of the stock exchange on the ground that the member failed to carry

out his engagement. Their Lordships justified the existence of such a clause on the ground that the Articles of Association are in the nature of a contract and the forfeiture of the shares is in the nature of a penalty authorised u/s 74 of the Contracts Act.

19. At this juncture, the decision of the Madras High Court reported in *Madhava Ramachandra Kamath v. Canara Banking Corporation Limited*. (1941 Vol. XI 78) requires an examination as it was heavily relied upon by the learned Counsel for the first respondent and also by the Company Law Board in support of its decision. It was a case where the shareholder of a banking corporation was expelled by a special resolution of the General Body. Under the Articles of Association; however, on the date of passing of such a resolution the banking company had no power to deal with the shares of such expelled members. Subsequently, the company altered its Articles of Association whereby the company could compel the shareholder to transfer his shares at a price which was to be fixed under the provisions of the Articles of Association and also the company was enabled to authorise one of its directors to sign the necessary instrument of transfer on behalf of the member who is required to compulsorily transfer the shares. The learned single Judge of the Madras High Court held that the amended article which purported to confer power on the directors to transfer the shares of an expelled member was ultra vires of Section 34 of the Indian Company Act, 1913.

20. The learned Judge held that the amended Articles of Association which fell for consideration before him was inconsistent with the requirement of Section 34(3) of the Indian Companies Act, 1913, as u/s 34 (3) of the Act the instrument of transfer was required to be executed by the transferor and the transferee. Sub-section (3) of Section 34 reads as follows:

"It shall not be lawful for the company to register a transfer of share in or debentures of the company unless the proper instrument of transfer duly stamped and executed by the transferor and the transferee has been delivered to the company along with the scrip:"

Where as Section 108 of the Companies Act, 1956 which broadly corresponds to Section 34 of the Repealed enactment recognises that the instrument of transfer could be executed either by or on behalf of the transferor and by or on behalf of the transferee. Sub-section (!) of Section 108 reads as follows:

"A company shall not register a transfer of shares in or debentures of, the company, unless proper instrument of transfer duly stamped and executed by or on behalf of the transferor and by or on behalf of the transferee and specifying the name, address and occupation, if any, of the transferee, has been delivered to the company along with the certificate relating to the shares of debentures, or if no such certificate is in existence, along with the letter of allotment of the shares or debentures:"

21. Therefore, the language of Section 34(3) on the basis of which the above-

mentioned judgment of the Madras High Court was rendered is different from the language of Section 108 of the Companies Act, 1956. Section 108 of the "Companies Act, 1956 recognises that a transfer deed could be executed either by the transferor or on behalf of the transferor. In fact, the Madras High Court in the above-mentioned decision recognised exceptions to the rule contained u/s 34(3) of the Indian Companies Act, 1913. The learned Judge dealt with the exceptions in the following words:

"There are of course occasions when the transferor does not or cannot sign, such as when a Court sale has been held. In that event Order 21, Rule 80, of the CPC provides for the Judge or an Officer of Court directed by him signing the transfer instrument."

22. Therefore the requirement that only the transferor should execute the instrument of transfer is not absolute. More particularly in view of the language of Section 108 of the Act, which is already noticed. Such an execution could be on behalf of the transferor if it is authorised either by the transferor or by law. The unamended Article 13 of the Articles of Association authorised the execution of the instrument of transfer by one of the Directors in the contingencies contemplated therein. The amended Article 16-C adopted the same procedure for the cases covered under Articles 16-A and B. Therefore, I am of the opinion that the judgment of the Madras High Court has no application to the facts of the present case. Hence, it cannot be said that the transfer of the shares in question is in contravention of Section 108 of the Companies Act. To that extent, the decision of the Company Law Board must be held to be bad.

23. Coming to the question whether the decision of the company to cancel the membership of the first respondent is a bona fide decision or not. The principles of law in this regard is clearly stated in *Side Bottom's* case (supra) that such a compulsory transfer must be in the interests of the company, but not for the benefit of some of the shareholders even if they are the majority shareholders. Unfortunately, the Company Law Board has not examined this aspect. From the explanatory statement u/s 173(2) of the Companies Act appended to the notice of the Extraordinary General Meeting dated 30-11-1999, which is already extracted earlier in this judgment, it appears, that the first respondent and her husband are making complaints against the functioning of the company to the various authorities like the income tax authorities and banks. Those complaints are resulting in proceedings before the authorities where the company had to defend itself. Nothing is stated that such proceedings are resulting in detriment to the company as such. Obviously, those who are in the management of the company felt that all this is an avoidable nuisance.

24. Dealing with the legality of the alteration of the articles of association conferring the power of the company to expel one of the shareholders, the Court of Appeal in the *Sidebottom's* case (supra) held that such a power is subject to one limitation. Lord Sterndale M.R. J., in his judgment at page 162 held as follows:

".....The limitation is also stated by Astbury J., in *Brown v. British Abrasive Wheel Company*, (1919) 1 Ch. 290), to which I shall have to refer later on, and it is stated by Lord Wrenbury in the 9th edition of his book on the Companies Act, at p.25, that "Possibly the limitation on the power of altering the articles may turn out to be that the alteration must not be such as to sacrifice the interests of the minority to those of a majority without any reasonable prospect of advantage to the company as a whole"....."

In my view, the same test applies in deciding whether in given case the power was bona fide exercise or not. Applying this test, I do not find any material on record to hold that the decision of the first appellant to expel the first respondent shareholder, is with any reasonable prospect of advantage to the company as a whole nor is it established that all the activity of the first respondent and her husband in sending up various complaints resulted in any tangible damage to the company. In fact, by sending out the first respondent by cancelling her membership, there is no assurance that the first respondent or her husband would be stopped from sending the complaints against the company. In the circumstances, I am of the opinion that the action of the appellants herein in cancelling the membership of the first respondent will achieve no benefit or advantage to the company as a whole consequentially, the same must be held to be illegal.

25. For all the above-mentioned reasons, I do not agree with the reasoning of the Company Law Board in passing the order under appeal. The conclusion reached by the Company Law Board is right and I see no reason to interfere with the same. The appeal is therefore dismissed, but in the circumstances without costs.