

(1941) 08 AHC CK 0004
In the Allahabad High Court

Jagdish Prasad and Another

APPELLANT

Vs

Pt. Paras Ram and Others

RESPONDENT

Date of Decision : 11-08-1941

Acts Referred:

Citation : AIR 1941 All 360 : (1941) 11 AWR 260 : (1942) 12 CompCas 21

Hon'ble Judges : Braund, J

Bench : Division Bench

Final Decision : Dismissed

Judgement

Braund, J.—This is an application which is, in my view, quite hopeless. It appears that a company called the General Transport Company Ltd. was incorporated in 1938 with shares divided into two classes, A and B respectively. The General Transport Company Ltd. was incorporated as a private company with articles of association which restricted the right of transfer in a not unusual form. Articles 16 to 22, inclusive, provide in a very usual way that, except in the case of a transfer by a member to an immediate relative, no member was to be entitled to transfer his or her shares without giving the directors an opportunity as therein provided for finding a purchaser or purchasers from among the existing members themselves. I need not set out the actual articles, because they are there to read and, in fact, nothing actually turns on them in this case. There then follows Article 23, which again is a very common form of article and which is the material one in this case. It is in these words:

The directors may in their discretion, refuse to register the transfer of any share to any person whom it shall, in their opinion, be undesirable in the interest of the company to admit to membership, but such right of refusal shall not be exercisable in the case of any transfer made pursuant to Article 16, except for the purpose of ensuring that the number of members does not exceed the limit prescribed by Article 2. The directors may refuse to register any transfer of shares on which the company has a lien.

2. It happened that 90 of the shares of the General Transport Company Ltd. were held by another company called the Commercial Finance Company Ltd. This latter company on 12th January 1941 went into voluntary liquidation and the present applicants Messrs. Prasad and Chatterji, are its liquidators. On the liquidation of the Commercial Finances Company Ltd., it seems that its liquidators cast about to find a purchaser or purchasers for the shares it held in the General Transport Company Ltd., and, on 14th January 1941, the liquidators wrote a letter to the directors of the General Transport Company Ltd. in which they said that they had succeeded in obtaining purchasers for the shares and, in pursuance of Article 19, they required the company within 21 days either to find a member or members willing to purchase them or in the alternative to register the transfer. It purported to be, in short, a "sale notice" pursuant to Article 18. The proposed transferees were, in fact, three in number and were, I understand, actually shareholders and directors of the Commercial Finance Company Ltd. What the directors of the General Transport Company Ltd., did on receiving the letter of 14th January was to hold a board meeting to consider the matter and on 5th February 1941 the General Transport Company Ltd. wrote a letter to the liquidators. It was in these terms:

Dear Sirs,

With reference to your letter No. 23/41 of the 14th January 1941 we enclose herewith the true copy of Resolution No. 1 of the Board of Directors of this Company held on the 3rd day of February 1941.

Please acknowledge and oblige.

Thanking you.

Yours faithfully, for the General Transport Ltd. (Sd.) General Manager.

3. The actual resolution enclosed was in this language:

Resolved that the directors in their discretion under Article 23 of the Company, are not inclined to register the names of the intending purchasers named in their abovesaid letter, as they consider them unsuitable for admission as members in the interest of the company.

4. I should of course say that technically speaking no actual transfer was before them for registration. All the letter of 14th January had actually done was to give a sale notice u/s 18 of the articles. That however is not material. On those facts the liquidators have come to this Court to ask for an order on the directors of the General Transport Company Ltd. to make them accept the transfer by the liquidators to the three named persons and to register it accordingly. As I said in the beginning, in my view, this application is quite hopeless. In their affidavit in support of the application, after seating out the history of the matter, all that the applicants say is (by para. 10) that the action of the directors is mala fide and contrary to the interests of the General Transport Company Ltd. and (by para. 11) that the directors' decision is not "judicial." They allege that the majority of

the shareholders in the General Transport Company Ltd. are willing to recognize the transfer and they urge that as a ground why the directors should be compelled to register it. After these ex cathedra allegations of "mala fides" and lack of "judicial" consideration, they say (by para. 12) that

under the aforesaid circumstances the discretion of the directors should be deemed to have been actuated by malice and ulterior motives best known to them.

5. The respondents filed an affidavit in reply in which, in effect, they allege that they were not bound to give their reasons and finally by an affidavit in rejoinder, filed at the very last moment, the applicant brings forward a number of extremely vague and unconvincing charges against the directors. Now, the law applicable to matters of this kind is extremely clear. The leading case is that of *In Re Gresham Life Assurance Society; Ex parte Penney* (1873) 8 Ch. A. 446. The judgment of Mellish L.J. in that case has been referred to again and again in subsequent cases. He says:

But it is further contended that in order to secure the existing shareholders against being deprived of the right to sell his shares, the directors are bound to give their reason why they reject the transferee, and if they reject him without giving a reason that is a ground from which the Court ought to infer that they were acting arbitrarily. I cannot agree with that. It appears to me that it is very important that directors should be able to exercise the power in a perfectly uncontrollable manner for the benefit of the shareholders; but it is impossible that they could fairly and properly exercise it if they were compelled to give the reason why they rejected a particular individual.... I am therefore of opinion that in order to preserve to the company the right which is given by the articles a shareholder is not to be put upon the register if the board of directors do not assent to him, and it is absolutely necessary that they should not be bound to give their reasons, although I perfectly agree that if it can be shown affirmatively that they are exercising their power capriciously and wantonly, that may be ground for the Court interfering....

6. It is true that an article such as Article 23 of the articles of association of this company is not intended to enable directors to act in a way which Mellish L.J., describes as "arbitrarily" or "wantonly." But if a shareholder challenges the undoubted right of directors in a case like this to use their discretion, the burden lies heavily on that shareholder to allege with particularity and to prove such mala fides on the part of the directors as amounts to arbitrary and wanton conduct. Quite consistently with this view in *Duke of Sutherland v. British Dominions Land Settlement Corporation Ltd.* (1926) 1 Ch. 746, interrogatories were allowed to be delivered to directors as to the particular branch of the article under which they had exercised their discretion, but not as to the reasons which influenced them in exercising it upon that ground. Lord Tomlin in his judgment in that case says:

I think therefore on the construction of the article that the defendants are bound to say whether the directors declined to register because they do not approve of the transferee or because the transferor is indebted to the company, but that they are not bound to tell the plaintiff why in those circumstances the directors did not choose to register the transfer.... Prima facie the directors are assumed to act bona fide just as ordinary trustees in exercising powers are assumed to act bona fide. If anybody alleges the contrary the onus is on him to prove it, and if in fact he adduces no evidence at the trial which justifies a conclusion either that there has been no exercise of the discretion or that there has been a mala fide exercise of the discretion, then the mere fact that the directors have refused to give any reason for the exercise of the power, and for the manner in which they have exercised it, throws no suspicion on them or in any sense shifts the onus of proof so as to put upon them the burden of justifying that which they have done....

7. Reverting now to the present case, what is it that the directors of the General Transport Co. Ltd., have done? They have said that they are not prepared to register these transfers, because they consider the transferees to be unsuitable for admission as members in the interest of the company. That follows very closely the wording of Article 23 itself which speaks of persons "undesirable in the interest of the company to admit to membership." They have clearly indicated upon what ground under Article 23 they take this stand and, conformably with Sir George Mellish's judgment in *In Re Gresham Life Assurance Society; Ex parte Penney* (1873) 8 Ch. A. 446, there is no obligation whatever upon them to go any further and to give their actual reasons for having come to that conclusion. Nor, as Lord Tomlin puts it, are they to be exposed to suspicion of mala fides by reason merely of the fact that they have chosen to withhold their reasons. The applicants come here and tell me that the directors have acted mala fide and arbitrarily. And they have asserted that the very fact that they have given no reasons is proof of that. In my view, it proves nothing of the kind, because the directors are doing exactly what they are entitled to do. Nor, in my opinion, is it a circumstance that affects the matter one way or the other, even if it be true, that the majority of the shareholders would welcome these transferees. It is a first and elementary principle of company law that, when powers are vested in a board of directors by the articles of association of a company, they cannot be interfered with by the shareholders as such. If the shareholders are dissatisfied with what directors do, their remedy is to remove them in the manner provided by the articles. But so long as a board of directors exists and particular powers are vested in it by the articles, then they are entitled to exercise those powers without interference by the shareholders and it is, I think, irrelevant whether the shareholders approve of what the directors have done or not. For all these reasons, I must dismiss this application with costs.