

(1978) 12 GUJ CK 0001

In the Gujarat High Court

Case No : Appeal No. 14 of 1978, Civil Application No. 48 of 1978 in Company
Petition No. 19 of 1978

Master Silk Mills Pvt. Ltd.

APPELLANT

Vs

Dharamdas Hargovandas Mehta and Another

RESPONDENT

Date of Decision : 21-12-1978

Acts Referred:

Companies Act, 1956 — Section 111, 111(5), 155, 155(4), 43A

Citation : (1979) 20 GLR 964

Hon'ble Judges : B.J. Divan, C.J.; S.B. Majmudar, J

Bench : Division Bench

Advocate : I.M. Nanavait, for the Appellant; K.H. Bhabha, for the Respondent

Judgement

Divan, C.J.—This appeal has been filed against the judgment and order of our learned brother, S. H. Sheth J., in Company Petition No. 19 of 1978. By his judgment and order, our learned brother allowed the petition and directed the present appellant to rectify its register of shareholders by entering therein the name of the second respondent in this appeal as a member of the second respondent in this appeal as a member of the appellant-company in respect of shares held by respondent No. 2 and listed para. 3 of the petition. The appellant-company was to file the notice of rectification with the Registrar of Companies within thirty days from the date of the order in Form No. 21 in App. I to the Companies Act, 1956. The appellant-company was directed to pay the costs of the petition to the respondents herein. Thereafter, the present appeal was filed, and pending the appeal, the operation of the order of the learned judge regarding rectification of the register of shareholders was not required to be stayed because Mr. Hava for the respondents stated that his clients would not press for implementation of rectification of the register of shareholders.

2. Facts giving rise to this litigation are that respondent Nos. 1 herein is a shareholder of the appellant-company, Master Silk Mills Private Ltd., hereinafter referred to as the "Master Mills". Respondent No. 1 was the registered holder of

260 equity shares, 136 first preference shares and 36 second preference shares of the Master Mills. On February 15, 1976, the first respondent entered into an agreement with respondent No. 2 herein, New Mahalaxmi Silk Mills Private Ltd., hereinafter referred to as "New Mahalaxmi Mills". The first respondent is the chairman of the New Mahalaxmi Mills. The agreement was to transfer all the share of Master Mills held by the first respondent. On 10th March, 1976, the first respondent wrote three letters to the board of directors of the Master Mills. In one letter, he mentioned his desire to transfer 260 equity shares of Master Mills to any prospective buyer who was a shareholder of Master Mills. He further stated that he was prepared to do so at the latest break-up value of Rs. 737 per share. He requested the board of directors of the respondent-company to circulate his offer to the existing shareholders and let him know whether any one was willing to buy those shares at the value of Rs. 737 per share. He also stated in his letter that he would wait for four calendar months from the date of the said letter for receiving the reply to his letter. By his second letter of the same date, he stated that he was desirous of transferring 138 first preference shares of the face value of Rs. 500 each to any existing shareholder and requested the board of directors to circulate his offer to the existing shareholders. The break-up of each share was Rs. 312.50 and he laid down similar condition about four month's notice and waiting for a period of four months for reply to his offer. By the third letter, he expressed his desire of transferring 36 second preference shares of the face value of Rs. 500 each at the break-up value of Rs. 281.25. The board of directors were asked to circulate all these three offers regarding equity shares, first preference shares and the second preference shares to the existing shareholders and ascertain their wishes. On 29th March, 1976, Master Mills wrote to their auditors to determine the fair market value of the shares held by respondent No. 1 because the directors felt that the price quoted by the first respondent were far in excess of the fair value. On 12th March, 1976, respondent No. 1 wrote to the auditors that so far as the break-up value of the shares held by him was concerned, it had been worked out on the basis of balance-sheets of Master Mills for the year ending 31st December, 1974, and that he had been taxed on the basis of such break-up value under the W.T. Act. He further stated that the break-up value, being written down value, was very much on the lower side of the market value. On May 13, 1976, respondent No. 1 wrote to the auditors a letter in which he stated that pursuant to art. 73 of the articles of association of the Master Mills, transfer of shares could be effected at a price which the auditors of the company would testify to both fair market price as between a willing seller and a willing purchaser or at a price which could be agreed upon between the vendor and the Board. Respondent No. 1 further stated that he had a willing purchaser for his shares at the price stated in the transfer notice, dated 10th March, 1976. He, therefore, requested the auditors to take note of that fact while fixing the fair value of his shares. On July 9, 1976, the managing director of Master Mills sent a circular letter to all shareholders of the company in which he stated that a shareholder of that company had offered 260 equity shares, 136 first preference shares and 36 second preference shares for

sale at the fair value of these shares as fixed by the auditor, which were also mentioned in that circular letter. With these details, the managing director invited the existing shareholders to purchase the shares offered by respondent No. 1 if any one of them was interested in those share. On August 7, 1976, the managing director of Master Mills wrote to respondent No. 1 that the company had circulated his offer for sale of shares to the existing shareholders and that no offer was received from any existing shareholder to purchase the shares. He, therefore, stated in that letter that respondent No. 1 was entitled to transfer his shares to any purchaser subject to the provisions of the articles of association of Master Mills.

3. On August 21, 1976, on behalf of respondent No. 1 three letters were written to the managing director of Master Mills. By the first letter, he intimated to Master Mills that he was transferring to New Mahalaxmi Mills all his equity shares at the fair price fixed by the auditors of Master Mills. By the second letter, he intimated that he was transferring to New Mahalaxmi Mills all his first preference shares at the fair price fixed by the auditors and, similarly, by the third letter, he intimated to Master Mills that he was transferring to New Mahalaxmi Mills all his second preference shares at the fair price fixed by the auditors of the company. Along with the three letters, respondent No. 1 sent three transfer deeds duly stamped and executed by him as transferor and by New Mahalaxmi Mills as transferees. On December 23, 1976, Master Mills wrote to respondent No. 1 that the board of directors of Master Mills at a meeting held on that very day had unanimously decided to refuse registration of the said transfer. The transfer deeds and the relevant share certificates were, therefore, returned to respondent No. 1. By this letter, Master Mills did not disclose any reason why the registration of the transfer of shares was refused. Against this decision of the board of directors, an appeal was preferred by respondent Nos. 1 to the Central Government, purporting to be an appeal under s. 111 of the Companies Act, 1956. The appeal was preferred on 9th August, 1977. On December 20, 1977, the Under Secretary to the Company Law Board informed the attorney of the respondent No. 1 that the Central Government had no inherent powers under s. 111(5) of the Companies Act and that the Central Government did not have any jurisdiction to entertain the appeal filed by respondent No. 1. It was also intimated in that letter that respondent No. 1, if he so thought fit, might apply to the court under s. 155 of the Companies Act for the necessary relief.

4. Thereafter, respondent Nos. 1 and New Mahalaxmi Mills filed Company Petition No. 19 of 1978 and sought relief under s. 155 of the Companies Act. Various contentions were urged before our learned brother, but out of those several contentions, ultimately at the stage of appeal, Mr. Nanavati on behalf of the appellant, Master Mills, has confined his arguments only to two main contentions. His contentions is that under article 76 of the articles of association of Master Mills, any transfer by a member to an outsider is subject to the approval of the board of directors and since the board of directors did not approve of the transferee, namely, New Mahalaxmi Mills, rectification of the register could not be

granted. He urged in this connection that, unlike a public limited company, a private limited company is more in the nature of a partnership concern where there should be mutual confidence amongst the shareholders and, in the instant case, New Mahalaxmi Mills was a rival company engaged in more or less similar line of business as that of the petitioner-company and, therefore, the board of directors had justifiable reasons in refusing to register the transfer of shares from respondent No. 1 to New Mahalaxmi Mills. In this connection, Mr. Nanavati for the appellant urged that a private company is in the nature of a partnership of persons with mutual confidence in each other and the articles of private companies place positive restrictions on absolute transfer of shares and, in the instant case, the articles permit unrestricted transfer from lineal descendants or relatives of existing members. According to him, the principle laid down by the Supreme Court in *Bajaj Auto Ltd. Vs. N.K. Firodia and Another etc.*, , for guidance of courts exercising powers under s. 155 of the Companies Act do not apply to the case of a private limited company because a private limited company functions in the context of different provisions of law altogether. He further contends that even if the procedure laid down in the articles has been followed by the intending transferor and the intending transferee, ipso facto no right is created empowering the intending transferor to transfer the shares to a non-member unless the proposed transfer is approved by the board of directors. He contended in this connection that even if s. 155 of the Companies Act is couched in a wider language, jurisdictional fetter should be put on those powers in the case of a private company; if the private company points out compliance with the articles as a matter of principle, the court should not interfere with the exercise of discretion of the board of directors if they function within the four corners of the provision of the articles of association. He further contended that the question of testing the bona fides of the directors in disapproving the proposed transfer has to be circumscribed by the object with which the company was registered as a private company instead of as a public company and he contended that the reasons given by the directors for rejecting the transfer are germane to the interest of the company as distinguished from the interest of the transferor and cannot be described as mala fide.

5. Before dealing with the legal position, it may be pointed out that the total number of equity shares issued by Master Mills is 1920 and, in the instant case, we are concerned with a dispute regarding transfer of 260 equity shares held by respondent No. 1. It has been found by our learned brother, S. H. Sheth, J., on the materials before him that, though Master Mills and New Mahalaxmi Mills are both manufacturers of art silk, the position regarding their manufacturing activities is not on the same lines. Master Mills purchase art silk yarn and manufactures art silk cloth. This constitutes more than ninety per cent. of its business. It also carries on, to an insignificant extent, business of production of art silk cloth. So far as New Mahalaxmi Mills is concerned, the manufacture of art silk cloth consists of eight per cent. of its business while ninety-two per cent. of its business consists of processing art silk cloth. It is thus clear that what

constitutes the major part of the business of one company constitutes an insignificantly small part of the business of the other company. Moreover, Mr. Bhabha pointed out from the affidavits in the case that whereas Master Mills is carrying on its activities at Bhavnagar, New Mahalaxmi Mills carries on its activities in Bombay. Secondly, even as regards weaving of art silk cloth or manufacture of art cloth by New Mahalaxmi Mills, it is more like a job work where yarn supplied by customers is woven by New Mahalaxmi Mills and cloth thus prepared is given back to the customers at appropriate adjustment rates. Thus, the principal activity of New Mahalaxmi Mills is that of processing cloth or processing yarn into cloth for its customers, whereas Master Mills of Bhavnagar is essentially a manufacturing activity. Under these circumstances, the very basis of Mr. Nanavati's argument that New Mahalaxmi Mills is a rival concern is not tenable. In this connection, we may point out that, under s. 155(4) of the Companies Act, an appeal lies against a decision of the trial court under s. 155 under the following circumstances :

"155. (4) From any order passed by the Court on the application, or on any issue raised therein and tried separately, an appeal shall lie on the grounds mentioned in section 100 of the Code of Civil Procedure, 1908, (V of 1908) -

(a) if the order be passed by a District Court, to the High Court;

(b) if the order be passed by single judge of a High Court consisting of three or more judges, to a Bench of that High Court."

6. We will proceed in this case on the footing that the Code of Civil Procedure, 1908, prior to its amendment in 1976, will apply to the instant case. As pointed out by the Andhra Pradesh High Court in *Abdul Karim Babu Khan v. Sirpur Paper Mills Ltd.* [1969] 39 Comp Cas 33, a finding of fact arrived at by a company judge is conclusive and cannot be challenged in appeal under s. 155(4) of the Companies Act, except on the grounds mentioned in s. 100, Civil Procedure Code, 1908, viz., where a decision is contrary to law or where the decision has failed to determine some material issue of law or where there is substantial error or defect in procedure provided by the Code or any law in force. It is clear that the finding that New Mahalaxmi Mills was not a rival company and that there was no competition in business between Master Mills and New Mahalaxmi Mills, is a finding of fact and that finding of fact can only be disturbed on a point of law, not otherwise. No appeal lies regarding that particular finding of fact.

7. Mr. Bhabha for the respondents drew our attention to the affidavits filed in this case and pointed out to us that the case set out in the affidavit filed on behalf of the respondent, namely, that there has not been a single instance of competition in the past, has not been controverted in the subsequent affidavit filed on behalf of Master Mills by the managing director or by the principal officer, Thakar, of Master Mills. In our opinion, the finding of fact that there was no rivalry between Master Mills and New Mahalaxmi Mills cannot be disturbed, but Mr. Nanavati is right when he contends that it is not a finding of fact given by a court of law that

would matter opinion of the board of directors of Master Mills regarding the possibility of rivalry between the two concerns. In our opinion, the real crux of the matter is as to what transpired at the meeting of the board of directors held on December 23, 1976. English translation of the extract from the minutes of the meeting held on December 23, 1976, is Annex. I to the affidavit of B. K. Thakar, principal officer of Master Mills, and according to that extract of the minutes, the managing director of Master Mills informed the board of directors that if these shares were transferred to New Mahalaxmi Mills, the same company would have a holding 14 per cent. of share capital in Master Mills. At present, under the provisions of s. 43A of the Companies Act, if a body corporate held 25 per cent. of shares of a private company, the said company is to be deemed to be a public company, but if there is any change in the provisions of the Companies Act and the percentage is reduced below 14, there would be difficulties for Master Mills. Moreover, New Mahalaxmi Mills is having the same business as Master Mills and thus it could be considered as a rival company. The minutes proceed :

"The managing director also appealed to the directors to decide the matter keeping in view the past of the directors of the said company vis-a-vis our company. Thereafter, there was some discussion amongst the directors and Shri Trikamlal B. Shah proposed the following resolution :

Resolved that taking into consideration the circumstances as a whole, it is not in the interest of the company to transfer deeds submitted by Shri Dharamdas Hargovandas as stated by the managing director and therefore his application for transfer of shares is hereby rejected."

8. Dharamdas Hargovandas is the first respondent in the present appeal.

9. On June 24, 1978, Ramniklal B. Shah, managing director of Master Mills, also swore to an affidavit and in para. 4 of that affidavit, it has been stated :

"I say and submit that the only consideration which weighed with the board of directors at the time of considering the impugned transfer of shares of petitioner No. 1 in favour of petitioner No. 2, was the desirability of permitting a corporate body to become the shareholder of the respondent-company, which is a private limited company. Since the total membership of the respondent-company is of 48 members, permitting any corporate body to become the member of the respondent-company even if it is a private limited company, would attract the provisions of s. 43A. It was also considered that if petitioner No. 2 company becomes the member of the respondent-company it would immediately be a member holding more than 14% of the shares of the respondent-company and, in view of art. 71 of the articles of association of the respondent-company, the petitioner No. 2 company would be entitled to purchase directly from other members of the respondent-company shares to any extent and get them transferred to its name without any restriction whatsoever. In that event, the respondent-company will be left to the mercy of petitioner No. 1 company for continuing its character as a private limited company."

10. In para 6, it is once again reiterated :

"In these circumstances, the board of directors thought it desirable, in the interest of the respondent-company, that no corporate body should be permitted to become a member of the respondent-company and only with that consideration, petitioner No. 2 was not approved by the proposed transferee to become a member of the respondent-company."

11. It is thus clear that the only consideration which weighed with the board of directors of Master Mills in not approving New Mahalaxmi Mills was the consideration that a corporate body should not be permitted to become a member of Master Mills. That and that was the only factor which weighed with the board of directors in rejecting the application for registration of transfer. The question will have now to be examined whether this was a relevant and germane factor for the consideration of the directors while considering the question of approval of the transfer.

12. Articles 71 to 76 of articles of association of Master Mills are relevant for this purpose. Article 71 deals with transfer of shares by a member to any other member and is not, strictly speaking, relevant for our purposes. Article 72 deals with transfer of shares by one member to his wife and other relations and, again, it is not strictly germane to our purpose except explaining the scheme of these articles. Under arts. 73, 74 and 75, procedure is laid down when a member intends to transfer shares to an outsider, that is, neither to a member under art. 71 nor to a member of his family under art. 72. Transfers under arts. 71 and 72 are not required to be approved by the board of directors. Under art. 76, in the event of the whole of the said shares not being sold under the articles, the vendor may at any time within three calendar months after the expiration of the said 21 days, transfer the shares not sold to any person at the price so fixed as aforesaid, and the concluding words of art. 76 are :

"But the directors may, in their absolute discretion and without assigning any reasons, decline to register any such transfer of shares if the purchaser be a person of whom they do not approve."

13. In art. 59 of the articles, it has been provided :

"The directors may at any time in their absolute discretion without assigning any reasons decline to register any proposed transfer of shares. The directors shall so decline to eject registration of transfer if the provisions of art. 3 hereof would be contravened thereby."

14. Mr. Nanavati has drawn our attention to the passages from Palmer's Company Law, 22nd Edn., pp. 393-396 and arts. 40-12 and 40-15 on those pages. He has also drawn our attention to Gore-Brown on Companies, 43rd Edn., paras. 16.2 and 16.3. Ultimately, these passages in the standard text books by Palmer and Gore-Brown are based on two decisions of the courts in England. The first of these decisions is of the Court Appeal in England in *In re Bede Steam*

Shipping Company Ltd. [1917] 1 Ch 123. It must be pointed out that it was a case of a public company as distinguished from a private company and the head-note of the case says :

"A power for directors to refuse to register transfers of shares if "in their opinion it is contrary to the interests of the company that the proposed transferee should be a member thereof" only justifies a refusal to register upon grounds personal to the proposed transferee. It does not justify refusal to register transfers of single shares or shares in small number because the directors do not think it desirable to increase the numbers of shareholders, or because they think that the transfer is not bona fide, but that the transferee is the mere nominee of the transferor, and the transfer is made to increase the number of shareholders who will support him in a policy which the directors disapprove."

15. Lord Cozen-Hardy M.R. observed at page 133 of the report :

"In the case of *Ex parte Penney* [1872] 8 Ch 446 that great judge, Mellish L.J., says : "The directors have no right to say, "We will force a particular shareholder to continue a shareholder, and we will not allow him to transfer his shares at all." That would be an abuse of their power. In the same way it would be an abuse of this power to object, on any ground not applying personally to the transferee, to say, for instance, that a particular shareholder should not transfer his shares till he had given security for the calls." That lays down a principle which seems to me to be perfectly sound and a principle which has been followed, so far as I am aware, for at least forty years, and I should be very sorry in any way to infringe upon it. The point which is taken by Mellish L.J. is this : You may look and see personally who the transferee is. There may be personal objections to him; it may be because he is a quarrelsome person, it may be because he is an uncertain person, or it may be that he is acting in the interests of a rival company, or something of that kind. All those things are fairly included in the word "personal"; but to seek to say "We will not accept any transfer of a single share from a particular shareholder who holds a large number, is, it seems to me, an abuse of the power which was conferred by the clause in the articles."

16. Similarly, Warrington L.J. has observed at page 136 :

"The directors refused, on that view, to register this transfer; they thereby deprived the transferee of his right to be a member of the company; they deprived their fellow-shareholder of the right to sell his share and to retain the purchase-money, which, as I understand, he had actually received from the transferee. Was that justified by the articles ? The article gives them one ground, and one ground only, for refusing to register the transfer of a fully-paid share, namely, that in their opinion it is contrary to the interests of the company that the proposed transferee should be a member. I agree that, if they had simply expressed their opinion and we knew nothing more about it, it would not be for us to examine or to inquire into the ground on which they had formed that opinion; but in the present case we know on the facts that they formed no such

opinion at all, but the opinion they really formed was that it was contrary to the interests of the company that Mr. B. S. Elder should be allowed to transfer his shares singly or in small lots. That seems to me to be a ground not provided for by the articles. What the directors have done is in fact an attempt to give themselves the power, or to assert that they possess the power, to refuse to allow a transfer of shares in order that they may carry out some line of policy or assert some principle for the carrying out of which, or the assertion of which, the articles do not provide."

17. The next case from England in this connection is the decision in *In re Smith and Fawcett Ltd.* [1942] Ch 304 (CA). This was the case of a private company. Article 10 of the articles of association of the private company provided :

"The directors may at any time in their absolute and uncontrolled discretion refuse to register any transfer of shares, and clause 19 of Table A shall be modified accordingly."

18. The issued capital of the company consisted of 8,002 ordinary shares, of which the two directors of the company, J.F. and N. S. Held 4,001 each. J. F. died, and his son as his executor applied to have the testator's shares registered in his name. N.S. refused to consent to the registration, but offered to register 2,001 shares and to buy 2,000 at a fixed price. The executor applied to the court by way of motion that the register of members of the company might be rectified by inserting his name as the holder of the 4,001 shares. The Court of Appeal held that art. 10 gave the directors the widest powers to refuse to register a transfer, and that, while such powers were not of a fiduciary nature and must be exercised in the interests of the company, there was nothing to show that they had been otherwise exercised. In connection with the decision in *In re Bede Steam Shipping Co. Ltd.* [1977] 1 Ch 123 (CA), Lord Greene M.R. observed at page 307 (of [1942] Ch);

"It is perfectly clear from that observation that the court was not laying down a general rule to be applied to all forms of article, but was coming to a decision on the particular article before it, the future of which was such as to confine the directors to the consideration of one particular matter.

There is nothing, in my opinion, in principle or in authority to make it impossible to draft such a wide and comprehensive power to directors to refuse to transfer as to enable them to take into account any matter which they conceive to be in the interests of the company, and thereby to admit or not to admit a particular person and to allow or not to allow a particular transfer for reasons not personal to the transferee but bearing on the general interests of the company as a whole such matters, for instance, as whether by their passing a particular transfer the transferee would obtain too great a weight in the councils of the company or might even perhaps obtain control. The question, therefore, simply is whether on the true construction of the particular article the directors are limited by anything except their bona fide view as to the interests of the company."

19. It must be pointed out that the interests of the company, even when the article confers absolute discretion on the directors, is the guiding principle for the exercise of discretion of the directors in deciding to refuse or not to refuse a proposed transfer. Moreover, since the company before us is a private limited company, and in the nature of a corporate partnership or, what is classed as a close corporation in the U.S.A., it is but natural that the directors should approve of the purchasers to transfer shares in his favour who, on such transfer, will become a member of the company and it is for that purpose that art. 76 provides that the directors may, in their absolute discretion and without assigning any reasons, decline to register any such transfer of shares if the purchaser be person of whom they do not approve. But such approval, by the very nature of things, must be personal to the particular transferee in whose favour the transfer is proposed. It cannot be an absolute ban, as seems to be the case in the instant case, of not approving any transfer in favour of any corporate body. All corporate bodies cannot be bad and it is not open to the board of directors to say that they would not approve of any transfer in favour of any corporate body. Section 43A of the Companies Act was not going to be followed in the instant case because that section provides for a private limited company to be treated as a public limited company only if not less than 25 per cent. of the paid-up share capital is held by one or more bodies corporate. If that is the position, a private limited company shall, on the very day on which the aforesaid percentage is held by bodies corporate, become, by virtue of the section, a public company. It is true that at one stage there was a proposal that this percentage of 25 should be reduced to 10. The report of the Companies Act Amendment Committee proposed that the percentage should be reduced from 25 to 10. However, the Joint Committee of Parliament ruled otherwise and it observed :

"The Committee also consider it unnecessary to require a private company which has become a public company to pass a resolution for the change of its name."

20. The view of the Committee was that "reduction of the percentage of share holding from twenty-five to ten is likely to hamper the formation and growth of private limited companies in the small scale sector, especially in the rural areas and, therefore, the provisions of s. 43A(1) should not be disturbed" (vide Ramaiya's Guide to the Companies Act, 8th Edn.p. 128). Whatever the position might have been prior to 1974, at least in December, 1976, when the board of directors held their meeting on 23rd December, 1976, there was no ground for apprehending that the requirement of 25 per cent. of shares referred to in s. 43A(1) was going to be reduced below 14, and therefore, there was no possibility on the part of the board of directors that by virtue of the deeming provision of s. 43A(1) of the Companies Act, this private company would be treated as a public company with all the concomitants of the requirements of the company law regarding a public company. As the managing director in his affidavit dated June 24, 1978, has pointed out, the only consideration which weighed with the board of directors was that no corporate body should be permitted to become a member of the respondent-company, and as set out in para. 4 of the affidavit of

the managing director, it was because of a possibility of the percentage in s. 43A being reduced below 14 that they had arrived at this conclusion. There was nothing personal against New Mahalaxmi Mills as transferees, that weighed with them and the approval in this case was rejected, not because they had found anything wrong personally with New Mahalaxmi Mills, but what they found wrong was that it was a corporate body and they did not want any corporate body to become a shareholder of Master Mills. That consideration which was the only consideration which weighted with the board of directors was not germane to the exercise of the powers under art. 76 of the articles of association of Master Mills. Approval of the transferee means approval of the transfer personally as distinguished from laying down a rule that no corporate body would be allowed to join the company, Master Mills, as a shareholder. Under these circumstances, the board of directors have exceeded the powers conferred upon them by art. 76. Though the words purport to convey absolute discretion, it must be in the interest of the company and secondly, the words "approval of the transferee" mean approval of a particular transferee as a distinguished from laying down a broad line of policy so to say that they would not approve of any such transfer in favour of a corporate body.

21. In this connection, we may point out that after the matter was argued before our learned brothers S. H. Sheth J. about the policy decision taken about non-approval of transfers in favour of corporate bodies, our learned brother has observed "The second reason which has been advanced on behalf of the respondent-company (Master Mills) is that it is the policy of the respondent-company not to admit any other private limited company to its membership." He has further observed : "Reference to the policy decision and reference to past decision are not borne out by any evidence. Mr. K. S. Nanavati has, therefore, very rightly told me that he did not press these two grounds in support of the impinged decision or resolution. However, though he did not press it in support of the impugned resolution, it cannot be gainsaid that the impugned resolution was passes under circumstances which indicated one and only one state of affairs, namely, non-application of mind."

22. Then, our learned brother Sheth J. also came to the conclusion that the impugned resolution was passes by the directors in circumstances which indicated only one state of affairs that prevailed with the directors, namely, that it was a policy of the respondent-company not to admit any other private limited company or other body to its membership. Now, this sort of blanket decision does not mean that there was non-approval of the particular individual transferee and the articles required that the directors can refuse to register a transfer in the name of the purchaser if the purchaser was a person of whom they do not approve.

23. In Bajaj Auto Ltd. Vs. N.K. Firodia and Another etc., the Supreme Court considered the decisions, in *In re Smith and Fawcett Ltd.* [1942] Ch 304(CA) and in *In re Bede Steam Shipping Co. Ltd.* [1917] 1 Ch 123(CA) and also took into

consideration several other decisions bearing on the subject, and came to the conclusion (per Head Note of AIR) :

"Where the directors under the articles of company have uncontrolled and absolute discretion in regard to declining registration of transfer of shares, discretion does not mean a bare affirmation or negation of a proposal. Discretion implies just and proper consideration of the proposal in the facts and circumstances of the case. In the exercise of that discretion the directors will act for the paramount interest of the company and for the general interest of the shareholders because the directors are in a fiduciary position both towards the company and towards every shareholder. The directors are therefore required to act bona fide and not arbitrarily and not for any lateral motive."

24. At page 330 of the report, Roy J., as he then was, has summed up the position as follows (in para. 34) :

"The discretions of the directors is to be tested as the opinion of fair and sensible men in the interest of the company." It was also pointed out (at p. 9 of 41 Comp Cas; in para 22, at p. 327 of AIR) :

".... where the directors have uncontrolled and absolute discretion in regard to declining registration of transfer of shares, the court will consider if the reasons are legitimate if the directors have acted on a wrong principle or from corrupt motive. If the Court found that the directors gave reasons which were legitimate, the court would not overrule that decision merely on the ground that the court would not have come to the same conclusion."

25. In para. 25, they have referred to a decision of the Allahabad High Court in *Muir Mills Co. Ltd. v. T. H. Condon* ILR [1900] All 410, and there also the question was the absolute power of the Directors to refuse registration of transfer of shares on personal objections to the transferee. The *Muir Mills* in that case disallowed the transfers on the ground that the transferees were subordinates of McRobert, the managing director of Cawnpore Mills. There was personal animosity between Hohnson, the managing director of the *Muir Mills* and McRobert. The directors of the *Muir Mills* came to a conclusion that McRobert should not add to his voting power and "harass the management". This was found to be an abuse of the fiduciary discretionary power of the directors when they wanted to safeguard the director's personal interest against McRobert.

26. It is true that the case of *Bajaj Auto Ltd. Vs. N.K. Firodia and Another etc.*, was a case of a public company whereas the company before us is a private limited company, but the general principles under s. 155 are the same and s. 155 itself makes no distinction between a public company and a private company. All that we have to bear in mind is that when we are considering exercise of discretion by the directors of a private company, some more leeway should be given to them in view of the fact that a private limited company is a corporate firm or a partnership or more or less of that nature. So far as private limited companies are concerned, Palmer has pointed out in para 40-12 at p. 393 in

Palmer's Company Law, 22nd Edn. :

"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 instruction of a stranger as shareholder would be felt to be undesirable unless his admission is accepted by those for the time being interested in the company".

27. Even bearing this principle of a close corporation in mind, we have to see to it that the right of a shareholder to transfer his shares is not unduly restricted or is not fettered by the exercise of discretion by the board of directors of the private company for reasons which are not germane to the exercise of that power. The power is to be exercised against a transferee in the light of art. 72. "If the directors do not approve of the purchaser", these words upon the question of approval put a limitation on the power of the directors while exercising power under art. 76 and the limitation is that there must be something personal to the purchaser which prompts the directors not to approve of that particular purchaser. Therefore, what the directors were required to consider was whether New Mahalaxmi Mills was a purchaser of whom they disapproved on some personal grounds, that is, grounds personal to the transferee. However, we find from the affidavit of the managing director that the only consideration which weighed with the directors was the question of a possible infringement of s. 43A if that section of the Companies Act came to be amended and the possibility of the company being deemed to be public company under the provisions of s. 43A in that eventuality. The total number of issued shares being 1920, the limit of 25 per cent. would be reached if one or more bodies corporate were to hold more than 480 shares. However, the question before the directors was of 260 equity shares only and there is nothing on the record to show whether any other shares of Master Mills were held at the relevant date by any other body corporate. We are informed by Mr. Nanavati at the Bar that eight shares of Master Mills are held by Bank of Baroda, a corporate body. Even if those shares were to be taken into consideration, the total would be 268 shares being held by bodies corporate and, therefore, they would be far short of 480 shares which is the critical figure for the purpose of s. 43A.

28. Under the circumstances, we hold that the directors took into consideration a factor which was not at all germane to the requirement of art. 76 and, therefore, they have misapplied their mind and failed to apply their mind to the relevant factor which is required to be considered under art. 76, namely, whether there was anything personally wrong with New Mahalaxmi Mills which prompted the directors of Master Mills not to approve of New Mahalaxmi Mills as transferee.

29. Under these circumstances, our conclusion is that the refusal to register the transfer on the part of the directors was not in proper exercise of the power conferred upon them by art. 76 of the articles of association. Our conclusion is, therefore, identical with that of our learned brother Sheth J., and the line of reasoning which has appealed to Sheth J. has also appealed to us. This appeal,

therefore, fails and is dismissed with costs. In view of the orders in the main appeal, no further orders are necessary on the Civil Application.