

(1987) 04 KL CK 0025

In the High Court Of Kerala

Case No : M.F.A. No's. 296, 323 to 327, 332, 333, 334 and 337 of 1981

Mathew Michael

APPELLANT

Vs

Tekoy (India) Ltd.

RESPONDENT

Date of Decision : 10-04-1987

Acts Referred:

Civil Procedure Code, 1908 (CPC) — Section 100
Companies Act, 1956 — Section 111, 111(2), 111(3), 111(5A), 155
Securities Contracts (Regulation) Rules, 1957 — Rule 19(3)

Citation : (1990) 69 CompCas 145 : (1988) 2 ILR (Ker) 255

Hon'ble Judges : V. Sivaraman Nair, J;M.M. Pareed Pillay, J

Bench : Division Bench

Advocate : Mani J. Meenattoor, for the Appellant; Pathrose Mathai, for the Respondent

Final Decision : Dismissed

Judgement

This Judgment has been overruled by : M/S. Ammonia Supplies Corporation (P) Ltd. Vs. M/S. Modern Plastic Containers Pvt. Ltd. and Others, AIR 1998 SC 3153 : (1998) 94 CompCas 310 : (1998) 4 CompLJ 211 : (1999) 1 CTC 273 : (1998) 6 JT 116 : (1998) 5 SCALE 147 : (1998) 7 SCC 105 : (1998) 1 SCR 413 Supp : (1998) AIRSCW 3062 : (1998) 7 Supreme 191

V. Sivaraman Nair, J.—These ten appeals arise out of a common order of the learned single judge (M. P. Menon J.) dismissing the applications filed by the appellants u/s 155 of the Companies Act, 1956. All these appeals involve common questions. That was why the applications were dealt with by a common judgment by the learned company judge. We propose to deal with all these appeals in the same manner. Counsel on both sides agreed that this may be so.

2. The facts which are necessary are only just a few. The first respondent is a company limited by shares. Regulation 24 of the articles of association of the company provides that:

"The board of directors may, in their absolute discretion and without assigning any reason, decline to register,

(a) the transfer of shares to a person of whom they do not approve, ..."

3. The authorised capital of the company is Rs. 16,00,000 made up of 60,000 cumulative preference shares of Rs. 10 and one lakh equity shares of Rs. 10 each. The company is listed in the Madras Stock Exchange and its shares are quoted. The appellants, who were applicants before the company judge, purchased equity shares of the company at prevailing market rates. They forwarded such share certificates to the company along with share transfer deeds duly executed by the transferors for registration of the transfer. By letter dated August 14, 1979, the company informed the transferees that the board of directors had declined to register the transfer. The share certificates were returned along with that letter. But the share transfer deeds were kept back.

4. The transferees filed applications u/s 155 of the Companies Act, alleging that the refusal to register the transfer of shares was arbitrary, malicious, capricious, oppressive and without regard to the interests of the company or its shareholders. The directors of the company were said to have been purchasing shares in their names and in the names of their relatives and nominees at the same time. The refusal to register the transfers in the names of the appellants was said to be due to an anxiety of the directors to purchase the same shares from the original transferors at a lower rate. Regulation 24 of the articles of association of the company was said to be contrary to the right of the shareholders to freely deal with the shares and an unreasonable restraint of trade. It was also asserted that there was no personal reason why the directors should disapprove of anyone of the transferee-appellants.

5. The first respondent company resisted the application. The company maintained that the directors had only exercised their discretion under regulation 24 of the articles of association in the interests of the company and the shareholders, and they did not act on wrong principles or for collateral purposes or with oblique motives, that the directors knew the applicants for a long time and they bona fide believed that the transferees were persons who could not be approved of. It was also stated that some of the transfer deeds were incomplete and defective, and that they were rightly rejected. The concerned share transfer deeds were rightly produced in evidence as exhibits A-1 to A-10. Copies of the annual returns of the first respondent company made up to September 14, 1974, and September 29, 1979, were produced as exhibits A-12 and A-11, respectively. Exhibits A-13 and A-14 were resolutions of the company dated May 10, 1979, and September 25, 1979, respectively. Respondents produced exhibit B-1, copy of the memorandum and articles of association of the company and exhibit B-2 resolution regarding transfer of shares passed on August 14, 1978. Two of the transferees/ appellants were examined as PW-1 and PW-2. The office manager of the first respondent company was examined as PW-1. On an examination of all the materials available before him, the learned company judge held that the

directors had exercised their discretion properly, that they were not obliged to give reasons for their refusal to register transfer of shares because of the terms of regulation 24 of the articles of association of the company which bound the company as much as the .transferor members, that the refusal to register the transfer of shares was not arbitrary or capricious or malicious or oppressive or against the interest of the company or its shareholders and that the transferees had significantly failed in making out their case against the refusal by the board of directors by absolute proof or positive evidence. The appellants assail the above orders of the company judge.

6. Mr. Jagadischandran Nair, counsel appearing for the appellants, submitted that substantial questions of law arising for consideration in the appeal ought to have been formulated earlier because of the requirements of Section 155(4) of the Companies Act, read with Section 100 of the Code of Civil Procedure. He has now formulated such substantial questions of law in C. M. P. No. 1362 of 1987 and similar petitions seeking amendment of the memorandum of appeal. Those questions are the following :

"(1) Whether regulation 24 of the articles of association (exhibit B-O is void being in contravention of Section 82 of the Companies Act, 1956?

(2) Whether companies listed on a stock exchange, which have entered into agreements with the stock exchange, are legally bound to dispose of applications for transfer of shares within a period of one month of lodgement in accordance with Rule 19(3)(e) of the Securities Contracts (Regulation) Rules, 1957, notwithstanding the period of two months provided in Section 111 of the Companies Act, 1956 ?

(3) Whether the listing agreement and the Securities Contracts (Regulation) Rules, 1957, supersede the articles of association regarding power to refuse registration of transfer of shares in case of listed companies ? If not, how is the conflict, if any, to be resolved ?

(4) Whether it is open to the company court to direct the company to disclose the reasons for refusal to register transfer of shares ?"

7. In its counter-affidavit in the above CMP, the company maintained that the applications for amendment seeking to formulate the questions of law were not entertainable, that the questions sought to be raised were not substantial questions of law nor did they arise from the judgment of the learned company judge and that, in any case, questions Nps. 2 and 3 were new points which were never urged in the earlier proceedings.

8. We have searched in vain to find whether questions Nos. 2 and 3 sought to be raised by the appellants were even mentioned in the course of the proceedings before the company judge. The detailed facts necessary to enable the appellants to urge these points are not seen to have been made out in the fairly lengthy trial before the company judge. In the absence of factual details, it is not

possible for us now to permit the appellants to raise these new points of law. We did not restrain counsel from making his submissions on all points which he thought were relevant. On a closer examination of the factual details, we find that it will be absolutely unfair to go into the questions of law which may require a lot of factual information for a satisfactory determination of the points sought to be made out by the petitioner.

9. The assumption which the appellants made to justify the application for amendment was that by reason of the provisions contained in Section 155(4) of the Companies Act, read with Section 100 of the Code of Civil Procedure, an appeal may be incompetent if substantial questions of law were not formulated by the appellants at the time of filing the appeal. We do not think that the language of Section 155(4) of the Companies Act can lend itself to this extreme position. Section 155(4) of the Companies Act reads as follows:

"(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,--

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

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

10. To us it appears that as per the requirements of Section 155(4) of the Act, an appeal will be confined to the grounds mentioned in Section 100 of the Code of Civil Procedure. That provision does not incorporate the entire body of Section 100 of the CPC into Section 155(4). It only indicates the nature of the grounds on which an appeal may be entertained. It does not prescribe the procedural formalities applicable to a second appeal under the CPC to appeals u/s 155(4) of the Companies Act. Absence of formulation of substantial questions of law does not appear to us to be a defect in the memorandum of appeal. The only requirement of that provision seems to us to be that an appeal on facts is totally precluded. So is an appeal on question of law which is not substantial. In this view, it is not necessary for us to entertain or allow the application for amendment. CMP No. 1362 of 1987 is, therefore, dismissed. Such dismissal will not, however, preclude the appellant from raising the substantial questions of law arising out of the judgment of the company court. We have, therefore, heard Sri Jagadischandran Nair, counsel for the appellant, at length on what he urges as substantial questions of law arising out of the judgment, viz., whether regulation 24 of the articles of association contravenes Section 82 of the Companies Act, 1956, and whether it is open, to the company court to direct the company to disclose the reasons for refusal to register the transfer of shares.

11. Both these questions have been dealt with in very great detail by our learned brother while disposing of the applications. He has referred to the historical background and philosophical justification for entrusting a fairly wide area of discretion with the board of directors of voluntary trade organisations like

companies in the matter of admitting and entertaining members on their rolls. The development of the English law based on the principle *laissez faire* has been sketched out in illuminating detail. The need or the desirability for adapting these notions to the transformations in a socialistic society where individual proprietorship is sought to be abolished, and where greater emphasis on social control of means of production is sought to be achieved has also been adverted to. Notwithstanding such desirability, the learned judge has emphasised that as long as voluntary trade organisations like companies continue, a large amount of discretion for such organisations to choose their members without impairing the interest of the company or its shareholders or general public interest has to be recognised as a fact of life. We need only add that if the interest of the company or the shareholders or public interest are not affected, we have to go strictly by the terms of the articles of association to evaluate the right of the board of directors in the matter of admission of members, registration of transfers and other like matters. We have also to bear in mind that the articles of association is a contract of incorporation. The internal discipline for a voluntary organisation is a matter to be preserved by the organisation itself by insisting upon strict adherence to the terms of that contract. Courts may have power to review the working of such terms of the contract when a complaint is raised before it, that the power is being exercised in a malicious or arbitrary or oppressive or capricious manner or in a manner contrary to the interests of the company or its shareholders. It is elementary that when such a complaint is made, it has to be established by absolute proof and by positive evidence. An averment, an allegation or an assertion will not amount to absolute proof by positive evidence. Unless we reach that degree of proof of oblique motives or collateral purposes vitiating the action of a voluntary trade organisation in the matter of enlistment and admission of members, the court shall not ordinarily intervene. This, we understand, is a basic reasoning adopted over the centuries by English common law and which has been scrupulously followed in Indian decisions under the Companies Act. Justice Menon, in the decision under appeal, has traced the genesis and growth of this principle through centuries of development in English law and the course of evolution in Indian law. The appellants can succeed only if they are able to make out that the conclusions drawn on this legal position by the company judge was a misdirection in law.

12. Sri Jagadischandran placed before us a very ingenious argument that this may not be the position in law after the amendment of Section 111 by incorporation of sub-Section (5A) in the said provision. What he submits is that in a case of refusal to register transfer of shares in a company, two alternative remedies are available to the person concerned. u/s 111 of the Act, an appeal lies from refusal to register transfer of shares, to the Central Government. Sub-section (5) of Section 111 now provides that:

"(5) The Central Government shall, after causing reasonable notice to be given to the company and also to the transferor and the transferee or, as the case may require, to the person giving intimation of the transmission by operation of law

and the previous owner, if any, and giving them a reasonable opportunity to make their representations, if any, in writing, by order, direct either that the transfer or transmission shall be registered by the company or that it need not be registered by it ; and in the former case/ the company shall give effect to the decision within ten days of the receipt of the order."

13. Sub-section (5A) which was incorporated by the Companies (Amendment) Act, 1960 provides that:

"(5A) Before making an order under sub-section (5) on an appeal against any refusal of the company to register any transfer or transmission, the Central Government may require the company to disclose to it the reasons for such refusal, and on the failure or refusal of the company to disclose such reasons, that Government may, notwithstanding anything contained in the articles of the company, presume that the disclosure, if made, would be unfavourable to the company."

14. The argument proceeds that in case an unsuccessful applicant for registration of transfer of shares files an appeal u/s 111(3) of the Companies Act, the appellate authority can compel disclosure of reasons for refusal to register transfer or transmission of shares and draw adverse inferences against the company if such disclosure of reasons is not made. But if the same person filed an application u/s 155 of the Act for rectification of the register of members, he cannot now compel such disclosure or draw upon such inference. This, according to counsel, is an absolutely anomalous situation. According to him, the power of the court u/s 155(4) and that of the Government u/s 111(3) to Section 111(5) is as much judicial. The refusal complained against in these alternative proceedings may be the same. Before the administrative appellate authority, he can seek a direction from the authority to compel the company to disclose the reasons for refusal. In that event, it must be equally possible for a company court u/s 155(4) to direct the company to disclose the reasons and examine the propriety of the same or draw an inference adverse to the company if such disclosure is not made. It shall not be as if a quasi-judicial administrative tribunal can compel disclosure of reasons, but not a regular court in an appeal, so proceeds the argument.

15. We have prefaced that this is a very ingenious argument. But there is only one difficulty in accepting the same. In a statutory appeal u/s 111(3) of the Companies Act, sub-section (5A) had to be incorporated by a specific amendment enabling the unsuccessful applicant to require the appellate authority to compel the company to disclose the reasons for refusal. It cannot be controverted that but for sub-section (5A), the Government of India would not have had that power. A similar amendment was not simultaneously made in Section 155 of the Companies Act. This must be obviously because the law-makers did not want to confer a power similar to Section 111(5A) on the company court. If a power is not conferred on the court, but was specifically conferred, on a corresponding appellate authority, it is not easy to assume that

such power is granted to the court as well, however alluring it may be to accept that submission Far more logical would be the conclusion that the position of the company court u/s 155(4) remains as it was u/s 111 of the Act before incorporation of sub-section (5A). In other words, the -company court has no such power as to compel disclosure of reasons in the absence of such enabling provision in Section 155 of the Companies Act similar to that of Section 111(5A) of that Act. We shall ordinarily interpret and apply the law and shall not add to or subtract from enacted law on the basis of our assumptions as to what the law should be. We are, therefore, not persuaded to accept the submission urged by counsel for the appellant that we shall assume the power granted to the appellate board u/s 111(5A) of the Companies Act.

16. Yet another argument urged by counsel for the appellant was that refusal to register the transfer of shares was contrary to the provisions of Section 111(2) of the Companies Act. He submits that the period of two months provided in that sub-section, within which refusal to register should be communicated, is the outer limit of time. It is also his submission that the board of directors is not entitled to wait till the outer limit, except in exceptional cases, and the present is not one such. To understand this submission, we have to read Section 111(2) of the Act, which is in the following terms :

"If a company refuses, whether in pursuance of any power under its articles or otherwise, to register any such transfer or transmission of right, it shall, within two months from the date on which the instrument of transfer, or the intimation of such transmission, as the case may be, was delivered to the company, send notice of the refusal to the transferee and the transferor or to the person giving intimation of such transmission, as the case may be.

If default is made in complying with this sub-section, the company, and every officer of the company who is in default, shall be punishable with fine which may extend to fifty rupees for every day during which the default continues."

17. We did not hear counsel for the appellant submitting that the notice of refusal was sent to the transferee and transferor beyond the period of two months, which is fixed by the above provision. What he submits is that the outer limit of time applies only to extraordinary cases ; and ordinarily, the refusal should have been communicated within a reasonable time, which shall be less than the maximum time. We are not persuaded to agree that reasonable time shall invariably be less than the time specified u/s 111(2) of the Act. It may as well, in most cases, be the same as the specified time. Counsel submitted that such reasonable period shall be a period of one month in view of Rule 19(3)(e) of the Securities Contracts (Regulation) Rules, 1957, which provides, that--

"A company applying for listing shall, as a condition precedent, undertake, inter alia...

(e) to issue certificates in respect of shares or debentures lodged for transfer within a period of one month of the date of lodgment or transfer and to issue

balance certificates within the same period where the transfer is accompanied by a larger certificate".

18. This argument was not specifically raised before the company court. We are not persuaded to hold that Rule 19(3)(e) of the above Rules has the effect of superseding or modifying Section 111(2) of the Act.

19. Counsel for the appellant was at pains to point out that the decision of a Division Bench of this court in South Indian Bank's case [1978] 48 Comp Cas 368, authorises this court, in a petition u/s 155 of the Companies Act, to review the refusal to register transfers. One of the appellants herein was the respondent in that appeal. Regulation 42 of the articles of the company concerned was almost identical to Article -24 in the present case. However, the resolution of the company refusing to register the transfer of shares did contain reasons, notwithstanding the absence of any obligation on the part of the company to state any reason at all. In other words, the company had abandoned its absolute discretion to refuse to register the shares without mentioning any reasons at all. The correctness of the reasons mentioned for refusal to register constituted the subject-matter of the appeal. This court found that the three reasons so stated were : (a) it was an attempt at cornering of the shares of the company ; (b) it was an attempt to circumvent the provisions of Section 12(2) of the Banking Regulation Act, 1949 ; and (c) it was in contravention of the policy of the Reserve Bank of India. It has to be noted that this court took notice of the fact that there was no personal objection to any of the transferees. The validity of the three stated reasons for refusing to transfer the shares was considered by this court. It was found that all the three stated reasons were untenable. It was held (at page 376) :

"Cornering of shares or an attempted cornering of shares is not a reason personal to the transferee, and it is not a legitimate reason coming within regulation 42. The same is the position in regard to the other reasons mentioned in exhibit R-1. It is, therefore, manifest that the directors exceeded their authority under the articles and consequently their refusal to register the transfer of shares was ultra vires their power and is of no effect."

20. That decision is not an authority for the proposition that even in the case of absolute discretion conferred on the board of directors to refuse to register transfer of shares without stating any reason, the company court shall compel disclosure of such reasons in proceedings u/s 155 of the Companies Act.

21. Reliance Was sought to be placed on the decision in Harinagar Sugar Mills Ltd. Vs. Shyam Sundar Jhunjunwala and Others, . It was observed in that decision that proceedings u/s 111(3) or Section 155 of the Act are two alternative remedies available to a person whose application for transfer of shares was refused by the company ; and that the court shall, in exercise of its power u/s 155, adjudicate upon the right exercised by the directors in the light of the powers conferred upon them by the articles of association. We do not find

anything in that decision which lends support to the proposition advanced by counsel for the appellant, that in all cases of refusal to register applications for transfer, the company court is bound to compel disclosure of all reasons leading to the refusal and adjudicate upon the propriety of such reasons. On the other hand, it was definitely held that the court may have such power to order transfer which the directors, in their discretion, had refused, "only if it is satisfied that the exercise of the discretion is mala fide, arbitrary or capricious and that it is in the interest of the company that the transfer should be registered". We understand the above decision to mean that the discretion exercised by the directors in terms of the articles of association of the company is entitled to considerable weight, and that this inference of bona fides in exercising the discretion can be off-set only by proof of its absence or proof of arbitrariness, capriciousness, or contrary to the interests of the company.

22. The same question was considered by the Supreme Court of India in *Bajaj Auto Ltd. Vs. N.K. Firodia and Another etc.*, , and this was what the court had to observe :

"If the articles permit the directors to decline to register transfer of shares without stating the reasons, the court would not draw unfavourable inferences against the directors because they did not give reasons. In other words, the court will assume that the directors acted reasonably and bona fide and those who allege to the contrary would have to prove and establish the same by evidence. Where, however, the directors gave reasons, the court would consider whether they were legitimate and whether the directors proceeded on a right or wrong principle."

23. On a scrutiny of evidence, we do not find anything which renders improper the finding of the learned company judge, that none of these vitiating factors were proved by positive evidence.

24. The effect of the decision of the Calcutta High Court reported in *Babulal Choukhani Vs. Western India Theatres Ltd. and Another*, , is not any the different from the decision of the Supreme Court referred to above. It was observed by P. B. Mukharji J., speaking on behalf of the Bench (at page 574 of 28 Comp Cas) :

"The directors may at their absolute and uncontrolled discretion decline to* register or acknowledge any transfer of shares and shall not be bound to give any reason for such refusal. That is the first part of Article 52, It is, subject to the discretion having been exercised, absolute and uncontrolled. The latter part of the article is only illustrative of the grounds on which the directors could decline to register but not exhaustive. It does not control the absolute and uncontrolled discretion given in the first part of Article 52 ... Even in a case where the articles of association give uncontrolled and absolute discretion to the directors to decline to register transfer of shares and also gives them power to withhold reasons for such refusal, if it is shown that there has been no exercise of any discretion but an exercise of a whim or a caprice, then such purported

exercise of power under such an article can be examined by the court."

25. Here again, a closer scrutiny by the court could be attracted only if it was positively proved that there had been no exercise of discretion but only an exercise of a whim or caprice, or the decision of the directors was oppressive, capricious, or mala fide or not in the interests of the company at all.

26. Counsel for the appellants sought to rely on Clauses 3(c) and 12(a) of the Listing Agreement Form (Appendix B to regulation 2), to make out that the company was obliged to register the transfer within one month from the date of lodgement of transfer, and in case of refusal, was obliged to take the president of the .stock exchange into confidence, when so required, as to the reasons for such rejection. We do not propose to consider the submissions made on this aspect, because no such contention was apparently raised before the learned company judge.

27. Counsel for the appellant raised a contention with specific reference to exhibits A-11 and A-12, annual returns of the company made up to September 29, 1979, and September 14, 1974, respectively. He took us through the details of those two returns and pointed out various instances where shares were transferred in the names allegedly of relatives of the directors of the company. On the basis of these facts, it was submitted that there was a consistent attempt at cornering shares of the company and in refusing to transfer shares in the names of outsiders. The evidence of PW-2 was to the effect that he was not aware of the price at which such shares were purchased. Nor could he deny that they were purchased at the rate of over Rs. 30 per share. The allegation which was made by PW-1 to the effect that those in management of the company were attempting to reduce the value of shares and acquire them in the names of their relatives could not, therefore, be made out from the mere fact that the transfer of shares was in favour of others, some of whom were related to some of the directors of the company and the alleged transfers were effected on November 30, 1978, September 7, 1979, and June 9, 1979. We are of the opinion that the learned company judge was right in holding that the appellants had not succeeded in proving by positive evidence that the directors acted arbitrarily, capriciously or corruptly.

28. The appellants, admittedly, are members of the same family. Admittedly, the directors of the first respondent company belong to or are closely related to Kottukapally family and many of the directors are residing in the same town. It is not disputed that they knew each other fairly well for some considerable time. In these circumstances if the directors thought that the appellant-transferees could not be approved of, the exercise of discretion in that regard cannot be considered as totally arbitrary, capricious, whimsical or oppressive or against the interests of the company. None of these factors, the existence of which alone will justify a further probe by the company court, was made out on evidence by the appellants. The reason for refusal to register the shares in the names of the transferees was obviously personal to them. A further disclosure of reasons

cannot be compelled in view of the specific terms of Clause 24 of the articles of association of the company. We are in entire agreement with the findings of the learned company judge that the appellants were not entitled to seek a direction from the company court to compel disclosure of reasons in any greater detail than was contained in the resolution of the board of directors.

29. In this view, the appeals have to fail. They are dismissed in affirmance of the common judgment of the learned company judge. The appellants will pay the costs of the respondents in these appeals.