

**(1948) 03 BOM CK 0018**

**In the Bombay High Court**

**Case No :** O.C.J. Appeal No. 85 of 1947 and Suit No. 347 of 1945

Nanalal Zaver

APPELLANT

Vs

The Bombay Life Assurance Co., Ltd.

RESPONDENT

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**Date of Decision :** 11-03-1948

**Acts Referred:**

Companies Act, 1956 — Section 105(c)

**Citation :** AIR 1949 Bom 36 : (1948) 50 BOMLR 413

**Hon'ble Judges :** M.C. Chagla, C.J.;Tendolkar, J

**Bench :** Division Bench

**Final Decision :** Dismissed

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## Judgement

M.C. Chagla, C.J.—This is an appeal from a judgment of Mr. Justice Bhagwati and the facts leading up to it may be briefly summarised. The first defendant company is a limited company which was incorporated in the year 1908. It does life assurance business. Its authorised capital is ten lakhs of rupees divided into 10,000 shares of Rs. 100 each. In 1945 the total number of shares issued was 5,404 paid up as to Rs. 25. The life fund of the company at the end of December 1948 was Rs. 2,30,000. Defendants Nos. 2 to 9 are the directors of the company and defendant No. 2 is the chairman of the board of directors. It seems that in July 1944 Sir Padampat Singhanian in search of fresh financial conquests entered the market and started purchasing shares of this company and these purchases were done through his agents in Bombay. The result of his wanting to purchase shares was to shoot up the price of the shares considerably and the shares which were ordinarily quoted at Rs. 250 went up as much as to Rs. 2,000 in March 1945. The result at the end of December 1944 was that as against defendant No. 2's group, viz. Manecklal Premchand's group holding 2,397 shares, the Singhanian group-and that is how I propose to call Sir Padampat Singhanian's party-had 2,517 shares.

2. On September 18, 1944, a meeting of the board of directors was convened and the chairman drew attention to the serious situation that had arisen owing to

the attempt of a group of persons to purchase the company's shares with a view to get the control of the management of the company and this board meeting decided to issue a circular to the company's shareholders acquainting them with the real facts. It was also decided to authorise the chairman to sign the circular and on the next day, September 19, a circular was issued to various shareholders drawing their attention to what was happening and requesting them to offer their shares if they wanted to sell them, in the first instance, to the chairman. On January 1, 1945, an application was made by the company to the Examiner of Capital Issues for a fresh issue of capital. The sanction was granted on February 20, 1945, and on February 21, 1945, a meeting of directors was called and at this meeting it was resolved to issue 4,596 shares and to call up Rs. 25 on each of these shares. The shares were to be issued at a premium of Rs. 75. It was also decided that these new shares, viz. 4,596, were to be offered in the first instance to the shareholders of the company as shown on the register of members of the February 20, 1945, in the proportion of four new shares to every five shares held by them in the capital of the company on that date. Applications for shares in accordance with the offer made had to be presented and the payment made at the registered office of the company in Bombay on or before March 10, 1945. The resolution also provided that any balance of the shares remaining out of this issue not applied for by March 10, 1945, shall be disposed of by the directors as they might consider best in the interests of the company. A draft circular which was to be issued to the shareholders containing this offer was also placed before the meeting of the board and was approved by the directors. This circular mentioned that the directors reserved the right in their absolute and uncontrolled discretion to accept or refuse any application for shares made by a person in whose favour the shareholder may renounce his right to the whole or any of the shares which the shareholder might be entitled to have allotted to him in terms of the circular. The directors also reserved the right to accept or refuse any application in respect of fractional certificates by a person who was not a shareholder of the company. In fact although 4,596 shares were issued, out of these 272  $\frac{4}{5}$  shares were not offered to the shareholders at all and the balance was offered in the proportion of four shares to every five shares held by the shareholders.

3. The plaintiffs, who are two shareholders of the first defendant company and who admittedly belonged to the Singhanian group, have filed this suit challenging this issue of new capital mainly on two grounds : (1) that the new issue contravened the provisions of Section 105(c) of the Indian Companies Act, and (2) that the issue of shares was not bona fide made in the interests or for the benefit of the first defendant company, but was resolved upon merely with the object of retaining or securing to the second defendant and his friends control of the first defendant company. The learned Judge who heard the suit decided against the plaintiffs on both these points and dismissed the suit. Hence this appeal.

4. The first question we have to consider is whether the issue of further shares

by the first defendant company contravenes the provisions of Section 105(c) of the Indian Companies Act. The scheme of that section is fairly clear. It is left to the discretion of the directors to decide whether an increase in the capital of the company is necessary or not. It is also left to their discretion to determine at what particular point of time the capital should be increased. The only obligation cast upon the directors is that if new shares are issued, then they should be offered to the members in proportion to the existing shares held by each shareholder. The object obviously of the section there should be an equitable distribution of shares and that the holding of shares by each shareholder should not be affected by the issue of new shares. The section also makes it incumbent upon the directors to inform the shareholders of the number of shares to which each shareholder is entitled and also limiting the time within which the offer if not accepted would be deemed to be declined. It is contended by Mr. Amin on behalf of the appellants that Section 105(c) makes it obligatory upon the directors to offer all shares which have been issued for the purpose of increasing the capital of the company, and, says Mr. Amin, that inasmuch as although 4,596 shares were issued 272  $\frac{4}{5}$  were not offered to the shareholders, there is a contravention of the section. According to Mr. Amin, each shareholder should have been offered  $\frac{4,596}{5,404}$  shares and whatever absurdity or anomaly might have resulted, the clear provisions of the statute should have been carried out by the directors.

5. once the object of the section is clear, and I have indicated what according to me is the object, then the Court must see to it that that object is not defeated by anything which might result in an absurdity or an anomaly. In providing that such shares shall be offered to the members in proportion to the existing shares held by each member, the Legislature did not intend that every one of the shares had to be offered irrespective of the practical difficulties that might result in the working out of such a proposal. In my opinion, such shares have to be offered as nearly as the circumstances would admit. In this case the directors by offering 4,596 less 272  $\frac{4}{5}$  shares produced a workable proportion, viz. four shares to the holder of every five shares, and so long as the principal object of the section was carried out and so long as what the directors did was merely to give a practical effect to the section and to work out its provision in a practical manner, in my opinion, there was no contravention of the section. It is said that in giving this construction we are interpolating words which the Legislature did not think fit to incorporate in the section. But it is a well established canon of construction that the Courts would even go to the length of adding words to a section if it be necessary in order to give a construction which is a reasonable construction and which helps the Court in achieving the object for which the section was enacted.

6. I should have put this construction on Section 105(c) if it stood by itself. But whatever doubt there might be on the subject is entirely eliminated when one looks at Regulation 42 which forms part of Table I of the Indian Companies Act. As is well-known, u/s 17 of the Act this schedule forms part of the articles of the company unless a company chooses to have its own set of articles. Certain

regulations are compulsory and they are deemed to be included in the articles of a company whether in fact a company includes them or not, and one of the regulations which is not of a compulsory character is Regulation 42 and that regulation says:

Subject to any direction to the contrary that may be given by the resolution sanctioning the increase of share capital, all new shares shall, before issue, be offered to such persons as at the date of the offer are entitled to receive notice from the company of general meetings in proportion, as nearly as the circumstances admit, to the amount of the existing shares to which they are entitled.

Therefore, when the Legislature enacted a standard form of articles in order to provide for the regulation of a company, it enacted that in offering shares the proportion had to be maintained as nearly as the circumstances would admit. If Mr. Amin's construction were sound, then Regulation 42 would be inconsistent with Section 105(c), and again it is a well established canon of construction that when you have two provisions in different parts of a statute dealing with the same subject matter, it is the duty of the Court as far as possible to reconcile the two provisions. Therefore, reading Section 105(c) and Regulation 42 in schedule I, Table A, there can be no doubt that what the Legislature intended and what they have expressed in Section 105(c) is a principle of equitable distribution which was has got to be carried out as practically as possible.

7. Mr. Amin has drawn our attention to Article 45 of this company's articles which deals with the same subject matter and Mr. Amin is right that as the company has an article with regard to this subject matter, Regulation 42 in Schedule I, Table A, would not apply to this company. In this Article 45 we do not find any provision with regard to offering of shares in proportion as nearly as the circumstances admit which we find in Regulation 42. The language of Article 45 practically corresponds to Section 105(c). Mr. Amin says that we must construe Section 105(c) in the light of Article 45 and not in the light of Regulation 42 in Schedule I, Table A. That, in my opinion, is an entirely untenable argument. Section 105(c) can only have one interpretation, whether it is applied to one company or to another company, and whether it is read in conjunction with one set of articles or another set of articles. The construction of Section 105(e) cannot possibly vary in accordance with the particular article which a company might choose to frame with regard to the question of the issue of shares. There is no obligation to try and reconcile the articles of a company with Schedule 105(c) because the Legislature has had no hand in the framing of the articles of a company. It is only because Regulation 42 in Schedule I, Table A, has been enacted by the same Legislature that has enacted Section 105(c) that the necessity arises for placing a construction upon Section 105(c) which is reconcilable with Regulation 42.

8. Mr. Amin says that instead of issuing 4,596 shares the directors should have issued 4,053 shares in which ease they would have been able to offer one share

for every three shares held by a shareholder. That is a totally wrong approach to the subject. It is not for the Court to decide how many new shares should be issued and to what extent the capital of a company should be increased. That is a matter entirely left to the discretion of the directors. As I said earlier, it is only when the issue has been resolved upon that the obligation is cast upon the directors to offer those shares in the particular manner indicated in Section 105(c).

9. It is then urged by Mr. Amin that the issue is illegal and invalid on the ground that the circular issued to the shareholders reserved the right to the directors to refuse to register any, nominee in whose favour a share or a fractional certificate offered might be renounced by the shareholder. Article 34 of the company's articles of association empowers the directors at any time in their absolute and uncontrolled discretion and without assigning any reason to decline to register any proposed transfer of shares, and Mr. Amin says that that power does not cover the case of a nominee applying to have his name registered as a shareholder of the company and Mr. Amin relies on a decision reported in *Pool Shipping Company Ltd., In re* [1920] 1 Ch. 251 which decided that letters of renunciation of bonus shares in favour of a nominee and of acceptance by that nominee do not, in the absence of special provisions to the contrary, amount to a "transfer" of shares so as to fall within and be subject to the articles of association of the company dealing with the transfer of shares of shareholders already registered. In the first place the question whether a nominee has or has not a right to be registered does not arise in this case. Further, in the case referred to there was no provision similar to the provision we find in the circular issued by the directors. There the Court was considering only the effect of the article which gave the power to the directors to refuse to accept a transfer of shares. Finally, we have in this case an article, Article 44, which deals with this very question and which gives the power to the directors to issue new shares upon such terms and conditions and with such rights and privileges annexed thereto as the directors might determine, and in any case I fail to see how the introduction of such a condition with regard to the recognition of nominees can possibly vitiate the whole issue of new shares.

10. Mr. Amin has also contended that the notice given within which application had to be made for new shares or for fractional certificates was too short and unreasonable. The circular was issued, as I have pointed out earlier, on February 21 1945 and application had to be made by March 10, 1945. Mr. Amin says that the time given was entirely insufficient and unreasonable. In my opinion, this question of sufficiency of notice has more a bearing upon the question of bona fides than upon the question of the legality of the issue, and I propose to discuss this contention in some detail when I come to discuss the question of whether the directors exercised their power bona fide or not.

11. Coming now to the main point which has been urged with considerable force by Mr. Amin at the bar, which is, whether the directors acted bona fide in

resolving upon this new issue of shares. In deciding to issue new shares the directors are exercising fiduciary powers, and it is clear that they should exercise those powers in the interests of and for the benefit of the company of which they are the directors. If they exercised this power merely for the purpose of maintaining their own control or retaining their own majority, then the Court would interfere and prevent the issue of new shares on the ground that the directors were guilty of a breach of faith towards the company of which they were the directors. But, if it was once established that the company was in need of additional funds and that the fresh issue was decided upon in order to make good those funds, then, whatever other motives might have actuated the directors, the Court will not interfere with the discretion exercised by the directors. However mixed the motives might be, if it is established that in fact the company was in need of funds, then it could not be said that the exercise of their fiduciary powers by the directors was not a bona fide exercise.

12. In this particular case it is urged and urged with considerable force that the reason which actuated the directors on February 21, 1945, in resolving to issue new shares was the fear that the Singhanian group would capture the company and oust the present directors from their vantage point and take control of the company itself. It may be that one of the factors that weighed with the directors was that consideration. It may even be that it weighed with them in a great deal. It may also be that the directors selected this particular time, viz. February 21, 1945, for the issue of these shares because of the impending danger of the majority of shares going into the hands of the Singhanian group with the necessary consequences. If, with all that, it is established before the Court that in fact on February 21, 1945, the company was in need of funds, that the funds were required for the working of the company, then the Court will not interfere with the discretion exercised by the directors, because the principle is obvious that if the new shares have been issued because the company needs funds, then it cannot be said that the discretion vested in the directors has been exercised not in the interests of the company or for the purpose of the company. It is only when that discretion is exercised solely for the personal ends of directors, for their personal aggrandisement, for keeping themselves in power, then undoubtedly that discretion cannot be said to have been exercised for the purpose of or in the interests of the company. This principle is clearly laid down in *Piercy v. S. Mills and Company* [1920] 1 Ch. 77. In that case the directors avowedly wanted to increase capital for the purpose of keeping control over the management and it was not even remotely suggested that the company was in need of funds. Under these circumstances it is obvious that the Court came to the only conclusion which it could, viz. that the issue of shares was a breach on the part of the directors of their fiduciary powers. But it is important to note that in the judgment of Mr. Justice Peterson it has been continuously emphasised that it is only when the power is exercised merely for the purpose of maintaining their control, or shares have been allotted simply and solely for the purpose of retaining their control, that the Court would interfere with the discretion of the

directors. Mr. Amin wants us to read this case to mean, which it does not mean, that the directors should exercise their power only for the purpose of the company and for the benefit of the company or, in other words, that if the Court were to find any motive weighing with the directors which is extraneous to the interests of the company, then the Court should interfere. That is certainly not the law. As I have said earlier, once it is established that the company is in need of funds, then any extraneous consideration which might have weighed with the directors, even any selfish motive that might have weighed with them, is really irrelevant and cannot tilt the balance against the Court holding that the company being in need of funds the issue of new shares was fully justified.

13. Therefore, addressing myself to the main and only question, whether the company was in need of funds or not, it appears that when the company applied to the Examiner of Capital Issues on January 8, 1945, it gave seriatim the reasons which necessitated the issue of fresh capital. Four reasons were given for which the proposed issue was to be made. One was to promote and form, and to be interested in, and take hold and dispose of shares in other companies having objects similar to those of this company or doing insurance business of any kind or nature whatsoever, such as fire, marine, aerial, transit, accident, or any other kind of insurance. The second was for the purpose of operating the House Purchase Scheme specially for the benefit of the policy-holders of the company, and the third was to extend the company's organisation in India and particularly in countries abroad where the company's small paid up capital has been a serious handicap. The fourth was to stand on equal footing and compete for business on equal terms with other similar institutions having large paid-up capital. After discussing the evidence on the point his Lordship proceeded:

14. We have given very careful thought to all the arguments advanced by Mr. Amin. Undoubtedly this is a case of high finance and we have been given a glimpse of what high finance can be, and there is great justification in what Mr. Amin has said as to the manner in which some of the things were done with regard to the affairs of this company. But ultimately we must come down to the one short and simple question, was the company in need of funds at the time when the directors decided upon the issue of new shares, and, in my opinion, there can be no doubt on the evidence led in this case that the answer to that question must be in the affirmative. If that be the position, all other considerations can be of no avail or of very little avail as against this central fact in this case, and, as I am satisfied as to the central fact, I would agree with the learned Judge who took the same view and come to the conclusion that the plaintiffs have failed to discharge the burden which lay upon them of establishing that the issue of new shares was not bona fide and not in the interests of and for the benefit of the company.

15. The result, therefore, would be that the appeal must fail and be dismissed with costs.

Tendolkar, J.

16. The facts giving rise to this litigation have been sufficiently stated in the judgment just delivered by my Lord the Chief Justice, and I shall not restate them. There are two questions which have been argued before us on this appeal : (1) whether the offer of shares to existing shareholders is contrary to the provisions of Section 105(c) of the Indian Companies Act, and (2) whether the new shares. were issued mala fide by the defendants simply and solely for the purpose of enabling them to retain their control over the affairs of the first defendant company.

17. With regard to the first question, Section 105(c) of the Indian Companies Act is in the following terms:

Where the directors decide to increase the capital of the company by the issue of further shares, such shares shall be offered to the members in proportion to the existing shares held by each member (irrespective of class) and such offer shall be made by notice specifying the number of shares to which the member is entitled, and limiting a time within which the offer, if not accepted, will be deemed to be declined; and after the expiration of such time, or on receipt of an intimation from the member to whom such notice is given that he declines to accept the shares offered, the directors may dispose of the same in such manner as they think most beneficial to the company.

18. A literal interpretation of that section would have required the directors in this case to offer to every shareholder 4596/5404th share for each share held by him. In order to avoid this result, it was urged by Mr. Amin for the appellants that the directors should have decided only to issue such a number of shares as would bear a convenient ratio to the shares already held. That argument to my mind is wholly untenable. Section 105(c) of the Indian Companies Act does not fetter the discretion of the directors with regard to the decision to increase the capital. They are entitled to exercise their rights with regard to that increase as they may deem proper. Section 105(c) only comes into effect after the directors have taken the decision to issue further capital; and, therefore, there is no substance in the contention that the directors should have issued not 4596 shares, as they decided to do, but should have instead issued some other number of shares. Having issued those shares, if Mr. Amin's contention is right and a literal interpretation is to be placed on Section 105(c) of the Indian Companies Act, they should have allotted the whole lot of shares in the proportion of 4596/5404. A mere glance at the statement showing the multiples in which the shares are held, which has been put in as Ex. No. 20 in this case, would clearly show how absurd and inconvenient the result would be. The question that we have to consider is whether we are bound to put upon Section 105(c) too literal a construction which would lead to such a result. To my mind, the answer is to be found in the Companies Act itself. In the first schedule to that Act in Table A, there is Article 42 which is in the following terms:

Subject to any direction to the contrary that may be given by the resolution sanctioning the increase of share capital, all new shares shall, before issue, be

offered to such persons as at the date of the offer are entitled to receive notices from the company of general meetings in proportion, as nearly as the circumstances admit, to the amount of the existing shares to which they are entitled. The offer shall be made by notice specifying the number of shares offered, and limiting a time within which the offer, if not accepted, will be deemed to be declined, and after the expiration of that time, or on the receipt of an intimation from the person to whom the offer is made that he declines to accept the shares offered, the directors may dispose of the same in such manner as they think most beneficial to the company. The directors may likewise so dispose of any new shares which (by reason of the ratio which the new shares bear to shares held by persons entitled to an offer of new shares) cannot, in the opinion of the directors, be conveniently offered under this article.

19. It is contended on behalf of the appellants that we should not look at this article, because admittedly it is not applicable to the first defendant company. They have in their own articles, Article 45, which provides for a similar contingency. But it does not follow therefrom that for the purpose of determining what is the true interpretation to be placed on Section 105(c) of the Companies Act the Court is not entitled to look at Article 42 in Table A. There may be cases in which both Section 105(c) and Article 42 in Table A apply; and the interpretation placed by this Court on Section 105(c) cannot be any different in those cases from the interpretation that we put upon it in this particular case. We have, therefore, to read Section 105(c) and Article 42 in Table A of the first schedule together; and it is our duty to reconcile them in so far as it may be possible. There is quite obviously one simple method of reconciling them; and that is that where Section 105(c) provides that the new shares shall be offered to the members in proportion to the existing shares held by each member, it contemplates that they shall be so offered "as nearly as the circumstances admit," which are the words used in Article 42. If we read Section 105(c) in that manner, then no question of any inconvenience or absurdity arises. It is perfectly true that in reading the section in that manner we have got to interpolate in Section 105(c) the words I have indicated above, viz. "as nearly as the circumstances admit;" but it is a recognised rule of construction that it is open to the Court to interpolate words to obviate the manifest inconvenience and absurdity of too literal a construction when the Court is satisfied that such an absurd result could not have been intended by the Legislature. I have no doubt in this case that the Legislature could not have intended the absurd result which a literal construction involves; and I am, therefore, of the opinion that Section 105(c) must be read as I have indicated above.

20. But, even on the footing of such being the correct interpretation of Section 105(c), Mr. Amin for the appellants has contended that the directors should in any event have offered the shares to the existing shareholders not in the proportion of 4:5 as they did but in the proportion of 5:6. If they did so, the result would have been that instead of 272  $\frac{4}{5}$  shares being left unoffered in the hands of the directors, a small quantity of about 90 shares would have remained

unoffered. But, if I am right in holding that u/s 105(c) the directors are bound to offer the shares to the existing shareholders in proportion to their holdings as nearly as the circumstances admit, then quite obviously the judges of such circumstances must necessarily be the directors of the company; and, except in a case when they decide Upon the proportion mala fide, the Court shall not interfere. In this case it was suggested that they decided to issue the shares in the proportion of 4:5 mala fide because they wanted to dispose of the balance of 2724/5 shares as they pleased. But that contention is based upon an entire misconception as to the powers of the directors in this case. The resolution which sanctioned this issue and the circular which was approved at the meeting of the board of directors clearly show that if any shares which were offered were not applied for, the directors would dispose of those shares in the manner they thought fit; but no provision whatever was made by that resolution for the disposal of these 2724/5 shares, and indeed no such provision could have been made under the articles of association of the company, because the power to dispose of these shares, if at all, vested under Article 45 in the company and not in the directors. That being so, there is no ground for holding that the directors acted mala fide in offering the shares to the existing shareholders in the proportion of 4:5, and we cannot interfere with their discretion in this matter.

21. Turning next to the second question which has been argued before us, the whole of this contention is based upon a decision of the Court of Chancery in *Piercy v. S. Mills and Co.* [1920] 1 Ch. 77. That was a somewhat gross case. The directors of a company there came to know that a majority of the shares of that company had been purchased by their manager and that the manager desired to become one of their co-directors. Thereupon the directors proceeded to allot certain shares to themselves and their friends with a view to convert the majority of the manager into a minority and thereby prevent him from becoming a director of the company. Under those circumstances, the Court of Chancery held that the power given to the directors enabling them to raise the capital was a fiduciary power and was to be exercised bona fide for the advantage of the company. The ratio of that case is, to my mind, correctly set out in the headnote which is in these terms:

When the company is in no need of further capital, directors are not entitled to use their power of issuing shares merely for the purpose of maintaining their control, or the control of themselves and their friends, over the affairs of the company.

22. That is the law which we have to apply to the facts of this case; and it becomes necessary, therefore, to consider whether fresh capital was necessary for the business of the first defendant company. On January 8, 1945, an application was made on behalf of the company to the Examiner of Capital Issues in which the purposes for which the company desired to raise further capital have been set out in paragraph 4. It is urged before us that prior to the date of this application no meeting of the board of directors had been convened to discuss

the question of making such an application or to discuss any of these purposes. That is perfectly true. Defendant No. 2, who was the Chairman of the board of directors, has given evidence and told us that he discussed the question informally with some of his co-directors excluding defendant No. 7, who was all along siding with the Singhania group, and this application was made as a result of such discussions. But to my mind, it makes no difference whatever whether this matter was previously discussed by a meeting of the board of directors.

23. What the Court has got to consider is, whether at the date when the directors decided to increase the capital the first defendant company was in need of funds. His Lordship then discussed the evidence on the point and concluded:

24. That being so, I am also of the opinion that the company legitimately was in need of funds for the purpose of starting branches abroad.

25. Numerous acts of the directors in relation to the fresh issue of shares were relied upon as evidence of their mala fides, I do not consider it necessary to deal with these acts at any length, because, even assuming that the directors did all these acts with the object of keeping the Singhania group out of control of the first defendant company, the moment it is established that the company was in need of further capital for legitimate purposes, the fact that the directors utilised such need for the purpose of establishing themselves more firmly in the saddle does not, in my opinion, render the issue of further capital either ultra vires or invalid. I have held that the company was in need of funds; and whatever may have been the conduct of the directors with regard to that issue, and howsoever it may have enabled them to make their position with regard to the management of the first defendant company stronger than it was before, the issue cannot thereby be rendered either ultra vires or invalid. I, therefore, respectfully agree that the judgment of the trial Court must be upheld and the appeal dismissed.