
(1970) 09 SC CK 0052

In the Supreme Court Of India

Case No : Civil Appeal No. 1626 of 1966

Naresh Chandra Sanyal

APPELLANT

Vs

Calcutta Stock Exchange Association Ltd.

RESPONDENT

Date of Decision : 25-09-1970

Acts Referred:

Contract Act, 1872 — Section 74

Citation : AIR 1971 SC 422 : (1971) 41 CompCas 51 : (1971) 1 SCC 50 : (1971) 2 SCR 483

Hon'ble Judges : J. C. Shah, J;A. N. Grover, J

Bench : Division Bench

Advocate : R.B. Datar, for the Appellant; B. Sen, N.R. Khaitan and B.P. Maheshwari, for the Respondent

Final Decision : Allowed

Judgement

Shah, J.-

1. Naresh Chandra Sanyal was the holder of a fully paid-up share of the Calcutta Stock Exchange Association Ltd.- hereinafter called 'the Exchange'. As a member of the Exchange he was authorised to carry on business as a broker in shares, stocks and securities in the hall of the Exchange. In December 1941 Sanyal purchased one hundred shares of the Indian Iron & Steel Company Ltd. from Johurmull Daga & Company, but did not arrange to take delivery of the shares on the due date. Johurmull Daga and Company sold the shares pursuant to the authority given to them by the Sub-Committee of the Exchange. The transaction resulted in a loss of Rs. 438/10/-. The Sub-Committee directed Sanyal to pay the amount due by him, but he failed to carry out that direction.

2. On January 7, 1942 the complaint of Johurmull Daga & Company was referred to the Full Committee of the Exchange. Sanyal failed to pay the amount directed to be paid by him and he was by resolution dated February 19, 1942 declared a defaulter. On September 1, 1942, at a meeting at which Sanyal was present, the

H Full Committee resolved that the share standing in his name be forfeited to the Exchange with effect from September 1, 1942 and that Sanyal be expelled from the membership of the Exchange.

3. Sanyal then instituted an action in the High Court of Calcutta on its original side claiming a declaration that the articles of the Exchange providing for "forfeiture of a fully paid up share were ultra vires and illegal" and that "particularly Articles 21, 22 and 24 were invalid"; that the share held by him had not been "properly forfeited" by the Exchange and that forfeiture of the share was "irregular, void and inoperative and was not binding upon him". He also claimed an order that he be restored to the membership of the Exchange and that the share register be rectified accordingly. In the alternative Sanyal claimed a decree for Rs. 55,000/- being the value of the share, or in any event to the surplus of the sale proceeds after "liquidating the debts due by him to the Exchange." The suit was resisted by the Exchange. The Trial Court dismissed the suit. In appeal under the Letters Patent the decree was confirmed. With special leave Sanyal has appealed to this Court in forma pauperis.

4. The relevant Articles of Association of the Exchange are these :

Article 21-"The Committee shall have power to expel or suspend any member or if being firm any member or authorised assistant of the firm in any of the events following :-

. (6) If the member or if being a firm any member or authorised assistant of the firm refuses to abide by the decision of the Committee in any matter which under these articles or under the Bye-laws for the time being in force is made the subject of a reference to the Committee.

.

Provided always that in every case arising under the provisions of Sub-section (5), (6), (7) and (8) of this Article no resolution for the expulsion of a member or if being a firm any member or authorised assistant of the firm shall be valid unless passed by a majority consisting of not less than two-thirds of the members of the Committee at a meeting specially convened for the purpose and at which meeting not less than two thirds of the members of the committee at a meeting specially convened for the purpose and at which meeting not less than seven members of the Committee shall be present.

Article 22-"Any member who has been declared a defaulter by reason of his failure to fulfil any engagement between himself and any other member or members and who fails to fulfil such engagements within six months from the date upon which he has been so declared a defaulter shall at the expiration of such period of six calendar months automatically cease to be a member."

Article 24-"Upon any member ceasing to be a member under the provisions of Article 22 hereof and upon any resolution being passed by the Committee expelling any member under the provisions of Article 21 hereof or upon any

member being adjudicated insolvent the share held by such member shall ipso facto be forfeited."

Article 27-"Any share so forfeited shall be deemed to be the property of the Association, and the Committee shall sell, re-allot, and otherwise dispose of the same in such manner to the best advantage for the satisfaction of all debts which may then be due and owing either to the Association or any of its members arising out of transactions or dealings in stocks and shares."

Article 28-"Any member whose share has been so forfeited shall notwithstanding be liable to pay and shall forthwith pay to the Association all moneys owing by the member to the Association at the time of the forfeiture together with interest thereon, from the time of forfeiture until payment at 12 percent per annum and the committee may enforce the payment thereof, without any deduction or allowance for the value of the share at the time of forfeiture."

Article 29-"The forfeiture of a share shall involve the extinction of all interest in and also of all claims and demands against the Association in respect of the share, and all other rights incidental to the share, except only such of those rights as by these Articles expressly saved."

Article 31-"The Association shall have a first and paramount lien upon the share registered in the name of each member and upon the proceeds of sale thereof for his debts, liabilities and engagements...."

Article 32-"For the purpose of enforcing such lien the Association may sell the share subject thereto in such manner as they think fit...."

Art 33-"The net proceeds of any such sale shall be applied in or towards satisfaction of the debts, liabilities, or engagements, residue (if any) paid to such member, his executors, administrators, committee, curator or other representatives."

The relevant bye-laws of the Exchange are :

"Settlement of Disputes.-All disputes, complaints and claims between by and against members shall, on the application of either party, be decided by the Committee or by a Standing or Special Sub-Committee appointed by the Committee for the purpose. In the event of the matter being decided by the Committee the decision shall be final and binding upon all members concerned but any member aggrieved with the decision of the Standing or Special Sub-Committee may, within seven days of such decision being given, appeal to the Committee whose decision shall be final. In the event of any member or members refusing, neglecting or failing to observe, carry out or comply with any decision of the Committee, or if no appeal is preferred, with the decision of the Standing or Special Sub-Committee, such member or members so in default shall be dealt with by the Committee under the rules, regulations and/or bye-laws of the Association for the time being in force."

"Bye-law 13-Defaulters.-Any member who shall fail to pay any subscription or other moneys due by him to the Association on due date, or who shall fail-to fulfil any engagement between himself and another member or members may be declared a 'defaulter' by the Committee and on such declaration his name shall be posted as a 'defaulter' on the notice board of the Association and so long as the name remains so posted he shall not be at liberty to exercise any of the privileges of membership."

5. Under the scheme of the Articles of Association of the Exchange, the Committee is authorised to expel or suspend a member on the ground, inter alia, that he refuses to abide by the decision of the Committee in any matter which is under the Articles or under the Bye-laws referred to the Committee. A person declared a "defaulter" because he fails to fulfil any engagement between himself and any other member or members within six months from the date on which he has been declared a defaulter, ceases to be a member of the Exchange and his share also stands forfeited. The share so forfeited is deemed to be the property of the Exchange. But the Committee must sell, re-allot or otherwise dispose of the share for satisfaction of the debts which may then be due and owing by the defaulter to the Exchange or to any of its members arising out of transactions or dealings in stocks and shares. Forfeiture of a share involves extinction of all interest in and also of all claims and demands against the Exchange in respect of the share and all other rights incidental to the share, but not the liability of the erstwhile member to discharge his liabilities to the Exchange. The Exchange has a first lien upon the share of a member and upon the proceeds of sale thereof for his debts and liabilities, and in enforcement of the lien, the Exchange may sell the share. The net proceeds of the share subject to the lien if sold will be applied in or towards satisfaction of the debts, liabilities or engagements of the shareholder and the residue, if any, paid to such member, his executors, administrators, committee, curator or other representatives.

In this appeal counsel for Sanyal contended,

that under the Indian Companies Act, 1913, a fully paid up share cannot be forfeited for failure to carry out any engagement by the shareholder other than an engagement to pay a call made by the Company to pay unpaid capital;

that the procedure followed by the Sub-Committee of the Exchange was irregular in that Sanyal had no notice of the meeting of the Committee to declare him a defaulter;

that the Committee had no authority under the Articles of Association to direct sale of the share; and

that in any event Sanyal was entitled to the balance remaining on hand with the Exchange after satisfying his debts, liabilities and engagements under the Articles of Association.

6. For failure to abide by the decision of the Committee in respect of his liability

to pay the amount of loss due to Johurmull Daga & Company Sanyal was declared a defaulter, and when he continued to remain a defaulter for six months he was by resolution of the Full Committee expelled from the membership of the Exchange. The Full Committee also resolved to forfeit his share. The Exchange thereafter disposed of the share for Rs. 55,000/-. The argument raised by counsel for Sanyal that a member of the Exchange forfeits his share only if a resolution expelling him and a resolution declaring him a defaulter are passed is without substance. The conjunctive "and" between the first two clauses of Article 24 is used to indicate an alternative, and does not make the two conditions cumulative. We agree with the observations of Panckridge, J., in *Surajmall Mohta v. Ballabhdas Mohta* ILR 63 Cal. 531. that Article 24 "is carelessly drawn, because, on its literal application, before his share could be forfeited, a member would both have to be expelled by the Committee under Article 21 and automatically cease to be a member under Article 22. Clearly this cannot be the intention of the article and it is obvious that by a slip, 'and' has been substituted for 'or'."

7. In any event the Full Committee passed on February 19, 1942 a resolution declaring the appellant a defaulter. The appellant did not carry out his engagements for a period of six months thereafter. By resolution dated September 1, 1942 at a meeting of the Full Committee the appellant was expelled from the membership of the Exchange and it was resolved that his share shall stand forfeited.

8. There is no provision in the Indian Companies Act, 1913, which restricts the exercise of the right of the Exchange to forfeit shares, for non-payment of a call only. The Indian Companies Act, 1913, made no provision relating to forfeiture of shares. By Section 17(2) of the Act, a company could adopt the regulations contained in Table A in the First Schedule but the Company was not bound to do so. Regulations 24 to 30 of Table A dealt with the power and the procedure relating to forfeiture of shares. Regulation 24, it is true, provided for exercise of the power to forfeit a share when there was default in paying calls, but no inference follows therefrom that the share of a member could be forfeited only for non-payment of a call made in respect of the share which was not fully paid up.

9. In *The Calcutta Stock Exchange Association Ltd. v. S.N. Nundy & Company* ILR [1950] 1 Cal. 235., Harries C.J. after examining the provisions of the Companies Act 1913 reviewed the decisions of the Courts in England and of the High Court of Calcutta and observed that the Indian Companies Act as well as the English Companies Act contemplate, recognize and sanction forfeiture generally and not for non-payment of calls only; that a company may by its Articles lawfully provide for grounds of forfeiture other than non-payment of call, subject to the qualification that the Articles relating to forfeiture do not offend against the general law of the land and in particular the Companies Act, and public policy; and that the forfeiture contemplated does not entail or effect a reduction in

capital or involve or amount to purchase by the Company of its own shares nor does it amount to trafficking in its own shares. The Court in that case was concerned to determine the true effect of the Articles of the Exchange which fall to be interpreted in this case.

10. This Court in *Sri Gopal Jalan and Company Vs. Calcutta Stock Exchange Association Ltd.*, ., also considered whether forfeiture of shares resulted in reduction of capital contrary to the provisions of the Companies Act where power of forfeiture was given by the Articles for failure to carry out an undertaking or satisfy an obligation of the member to forfeit the shares. The Court in that case was interpreting the Articles which fall to be interpreted in this appeal. The Court held that the Exchange was not liable to file any return of the forfeited shares u/s 75(i) of the Indian Companies Act, 1956 when the same were re-issued. The Court observed that when a share is forfeited and re-issued, there is no allotment, in the sense of appropriation of shares out of the authorised and unappropriated capital, and approved the observations of Harries, C.J. in *S.N. Nundy's case* ILR [1950] 1 Cal. 235. that "on such forfeiture all that happened was that the right of the particular shareholder disappeared but the share considered as a unit of issued capital continued to exist and was kept in suspense until another shareholder was found for it". In the view of this Court, the shares so forfeited may not be "allotted" in the sense in which that word is understood in the Companies Act. The Court also pointed out that re-issue of forfeited shares is not allotment of the shares but only a sale, for, if it were not so the forfeiture even for non-payment of call would be invalid as involving an illegal reduction of capital.

11. Article 27 of the Exchange it may be recalled is in terms mandatory. The share forfeited to the Exchange must be re-allotted or otherwise disposed of : it cannot be retained by the Exchange. The share after forfeiture in the hands of the Company is subject to an obligation to dispose it of. On that account there is no reduction of capital by mere forfeiture.

12. Mr. Datar appearing for the appellant however contended that in *Sri Gopal Jalan and Company Vs. Calcutta Stock Exchange Association Ltd.*, . the parties argued the case on the footing that Articles of Association of the Exchange were not invalid, whereas in the present case the validity of the Articles is challenged. But the Court in citing with approval the observations of Harries C.J. in *S.N. Nundy's case* ILR [1950] 1 Cal. 235. did in effect pronounce upon the validity of the Articles.

13. A forfeited share is, therefore, merely a share available to the Company for sale and remains vested in the Company for that purpose only. By forfeiting a share pursuant to the authority of the Articles of Association, no reduction of capital is achieved. We are unable to agree with counsel for Sanyal that forfeiture of shares is permissible only in cases expressly contemplated by Table A - Model Articles i.e. for non-payment of calls in respect of a share which is not fully paid up.

14. Subject to the provisions of the Companies Act the Company and the members are bound by the provisions contained in the Articles of Association. The Articles regulate the internal management of the Company and define the powers of its officers. They also establish a contract between the Company and the members and between the members inter se. The contract governs the ordinary rights and obligations incidental to membership in the Company. In the absence of any provisions contained in the Indian Companies Act which prohibit a Company from forfeiting a share for failure on the part of the member to carry out an undertaking or an engagement the Articles of a Company which provide that in certain events membership rights of the shareholder including his right to the share will be forfeited are binding. The Articles of Association of the Exchange expressly provide that in the event of the member failing to carry out the engagement and in the conditions specified therein his share shall stand forfeited. Articles 22, 24, 26, 27 & 29 of the Exchange relating to forfeiture of shares in certain events are therefore valid.

15. There is in our judgment nothing in the procedure followed by the Sub-Committee and the Full Committee which rendered the forfeiture of Sanyal's share illegal. It is not in dispute that Sanyal incurred liability in favour of one of the members of the Exchange to pay Rs. 438-10-0 in the transaction relating to the sale of Indian Iron & Steel Company's shares and he failed to discharge that liability. He continued to remain in default for six months even after the resolution of the Full Committee, and on that account he ceased to be a member and his share was forfeited. The High Court has found that the copies of the letters dated 9th, 10th, 16th, 17th and 20th December, 1941, and of 8th January, 11th & 19th February, 1942, were sent to Sanyal and the usual notices relating to the complaints placed before the Sub-Committee or the Full Committee were served upon Sanyal, that such notices were posted on the notice board of the Exchange that the appellant had opportunities at all stages of the proceedings to come before the Exchange and refute the charges made against him and that at no stage of the proceeding until September 1, 1942, did Sanyal appear before the Sub-Committee or the Full Committee. The High Court was of the view that the order had not been made against Sanyal contrary to the rules of natural justice. It is true that Johurmull Daga complained about the default committed by Sanyal on December 9, 1941 and the meeting of the Sub-Committee was held on December 10, 1941. Granting that the letter of the Sub-Committee enclosing a copy of the complaint dated December 9, 1941, sent by post to Sanyal may not have reached him because he had left Calcutta, he had still ample notice of the proceeding of the Subcommittee because intimation was given to him by the notice posted on the board of the Exchange. Sanyal raised no contention at any stage before the 'Sub-Committee or before the Full Committee that he had not received the notices of the meetings dated December 10, 1941, December 17, 1941, January 7, 1942 of the Sub-Committee and of the meeting dated February 19, 1942 of the Full Committee. Regularity of the proceedings of the Committees at the various meetings is not challenged before us. We are unable to agree with

the contention raised by counsel for Sanyal that the rules of natural justice were not complied with when the Sub-Committee and the Full Committee passed the impugned resolutions against Sanyal.

16. There is no substance in the plea that the Committee had no jurisdiction to order sale of the share forfeited. Article 27 declares that the forfeited share is the property of the Exchange and that the Committee of the Exchange shall sell, reallocate or otherwise dispose of the share, for satisfaction of all debts due by the member to the Association or to its members out of transactions in shares and stocks. Under its Articles the Exchange has, authority to sell the share and to appropriate the sale proceeds towards satisfaction of the debts, liabilities or engagements.

17. But we are unable to agree with the view taken by the High Court that the balance of the amount remaining due after satisfying the liabilities of Sanyal remained the property of the Exchange and that Sanyal had no right thereto. Under the stipulations contained in Articles 21, 22, 24, the share of the defaulter or expelled member stands forfeited for failure to fulfil his obligation. The share of Sanyal by express resolution was forfeited. After applying the amount realised on sale of the share towards satisfaction of the debts, liabilities and engagements of Sanyal to the Exchange and its members, the balance remaining in the hands of the Exchange had to be held for and on behalf of the appellant. That is expressly provided in Article 33. The expression used in Article 29 "The forfeiture... shall involve the extinction of all interest" is subject to those rights as by the Articles are saved, and Article 33 saves to the defaulting shareholder whose share is forfeited the right to the balance remaining with the Exchange. Even assuming that Articles 24 & 31 reserve to the Exchange two distinct powers—the power to forfeit and the power to exercise a lien, and that Article 33 only applies to sale in enforcement of a lien, and not to a sale under Article 27, we are of the view that the balance on hand after satisfying the liability of the defaulter must still be returned to the defaulting shareholder. The power to forfeit does not imply authority to appropriate the balance remaining in hand after satisfying the liabilities and obligations of the defaulter to the Exchange and its members. Any such implication would be contrary to the intendment of Section 74 of the Contract Act.

18. The power of the Exchange to forfeit the shares arises out of the Articles and its source is in contract. Forfeiture of share is in the nature of imposition of a penalty. Section 74 of the Indian Contract Act provides :

When a contract has been broken, if a sum is named in the contract as the amount to be paid in case of such breach, or if the contract contains any other stipulation by way of penalty, the party complaining of the breach is entitled, whether or not actual damage or loss is proved to have been caused thereby, to receive from the party who has broken the contract reasonable compensation not exceeding the amount so named or, as the case may be, the penalty stipulated for.

.

19. In *Fateh Chand Vs. Balkishan Das*, . this Court in dealing with a case in which a claim for damages for breach of contract to sell a lien of immovable property arose, pronounced that the expression "the contract contains any other stipulation by way of penalty" comprehensively applies to every covenant involving a penalty whether it is for payment on breach of contract of money, or delivery of property in future, or for forfeiture of right to money or other property already delivered. Duty not to enforce the penalty clause but only to award reasonable compensation is statutorily imposed upon courts by 74 of the Indian Contract Act. In all cases, therefore, where there is a stipulation in the nature of penalty for forfeiture of an amount deposited pursuant to the terms of a contract which expressly provides for forfeiture the Court has jurisdiction to award such sum only as it considers reasonable, but not exceeding the amount specified in the contract as liable to forfeiture. The same principles, in our judgment, would apply in the case in which there is a stipulation in the contract by way of a penalty, and the damages awarded to the party complaining of the breach will not in any case exceed the loss suffered by the complainant party. It was observed at p. 526 in *Fateh Chand Vs. Balkishan Das*, . :

The section (Section 74) is clearly an attempt to eliminate the somewhat elaborate refinements made under the English common law in distinguishing between stipulations providing for payment of liquidated damages and stipulations in the nature of penalty. Under the common law a genuine pre-estimate of damages by mutual agreement is regarded as a stipulation naming liquidated damages and binding between the parties : a stipulation in a contract in terrorem is a penalty and the Court refuses to enforce it, awarding to the aggrieved party only reasonable compensation. The Indian Legislature has sought to cut across the web of rules and presumptions under the English common law, by enacting a uniform principle applicable to all stipulations naming amounts to be paid in case of breach, and stipulations by way of penalty.

The Court also observed at p. 530 :

Section 74 declares the law as to liability upon breach of contract where compensation is by agreement of the parties pre-determined, or where there is a stipulation by way of penalty. But the application of the enactment is not restricted to cases where the aggrieved party claims relief as a plaintiff. The section does not confer a special benefit upon any party; it merely declares the law that notwithstanding any term in the contract predetermining damages or providing for forfeiture of any property by way of penalty, the Court will award to the party aggrieved only reasonable compensation not exceeding the amount named or penalty stipulated.

Granting that Article 33 deals with those cases in which lien alone is enforced and not in cases where forfeiture is levied, and the obligation of the defaulting shareholder is determined by Article 29, in our judgment, on the principle

underlying Section 74 of the Contract Act the Exchange had no right to hold out of the sale proceeds of the share any amount in excess of the amount due to it or to its members.

20. The Exchange may not purchase its own shares. If it does so, it amounts to reduction of capital. The legal theory of forfeiture is that a share forfeited is only taken over by the Company with the object of disposing it of to satisfy its claim to enforce which the share was forfeited and all other obligations arising against him out of his membership. The Company is given this right to recover the loss suffered by it by reason of the breach of contract committed by the shareholder. If the Company is permitted to retain the balance of the amount after satisfying the debts, liabilities and engagements of the shareholder, the transaction would not be different from one purchasing the share of the defaulting shareholder for a value equal to the amount of his obligations. That would be plainly illegal. We are therefore unable to agree with the High Court that the Exchange was entitled to retain the balance after satisfying the debts, liabilities and engagements of the appellant to the other members or to the Exchange.

21. The decree passed by the High Court is set aside and the case remanded to the High Court for determining the extent of the liabilities of the appellant to the Exchange not only in respect of the transactions with Johurmul Daga but in respect of all other outstanding liabilities of the appellant to other members of the Exchange and to the Exchange which are enforceable under the Articles. The appellant is entitled to receive from the Exchange the balance remaining due after deducting the aggregate amount or value of the obligations. He will be entitled to interest on the balance at the rate of 6% per annum from the date of the institution of the suit. Parties will bear their own costs throughout.

23. This appeal was filed in forma pauperis. The appellant will pay the court fee payable on the memorandum of appeal if he had not been permitted to appeal in forma pauperis.