
(1966) 12 AP CK 0004
In the Andhra Pradesh High Court
Case No : O.S. Appeal No. 4 of 1958

Praga Tools Corporation Ltd.

APPELLANT

Vs

M.R. Patny and Others

RESPONDENT

Date of Decision : 27-12-1966

Acts Referred:

Companies Act, 1913 — Section 28, 29, 38, 38(1), 38(2)

Citation : AIR 1968 AP 320

Hon'ble Judges : P. Jaganmohan Reddy, C.J.;Anantanarayana Ayyer, J

Bench : Division Bench

Advocate : N.V.B. Sankara Rao, for the Appellant; C. Jayashree Sarathy, for the Respondent

Final Decision : Allowed

Judgement

1. This is an appeal against a judgment of Satyanarayana Raju J.. (as he then was) sitting as a Company Judge in O. P. No. 8/6 of 1956, awarding damages of a sum of Rs. 2687-8-0 against the appellant Company for cancelling a transfer made by it in favour of the respondent M. R. Patny, on the ground that the action of the Company cannot be justified. The sole respondent M. R. Patny having died pending this appeal, respondents 2 to 8 have been brought on record as his legal representatives, of whom the 2nd respondent is the wife and respondents 3 to 8 are his sons and daughters.

2. The deceased M. R. Patny (hereinafter referred as "the respondent") filed an application u/s 38 of the Indian Companies Act, 1913, for rectification of the Share Register of the appellant Company by restoring his name as the owner of 100 shares bearing distinctive Nos. 54164 to 54263, comprised in share scrip No. 1331, or in the alternative, to direct the appellant to pay to the respondent a sum of Rs. 5000/- as damages. The appellant company thereafter referred to as "the company") was registered as a public limited company under the provisions of the Indian Companies Act. The authorised share capital of the company is Rs. 1,00.00,000 divided into one lakh ordinary shares of Rs. 50/-

each and one lakh 4% cumulative preference shares of Rs. 50 each. On 7th July, 1944. one hundred ordinary shares of the .company bearing Nos. 54164 to 54263 were allotted to Lakshmi Insurance Company Ltd., Lahore. A sum of Rs. 25/- was payable on each share on allotment, so that a total of Rs. 2,500/- was paid on the 100 shares, and a share certificate No. 1331 was issued by the company in favour of the allottee on that date. On 14-3-1946, the Insurance Company paid a sum of Rs. 1,250/- being the first call of Rs. 12-8-0 per share, and the same was duly endorsed on the share certificate. On 19-6-1946, the share holder transferred the shares in favour of one Haji Gaffar Haji Latif Saya of Nanded (hereinafter referred to as "the first transferee") and the same was endorsed on the share certificate on 4th July, 1946 On 1st February 1947 there is another endorsement of payment of Rs 1,200/- being the second call of Rs. 12-8-0 per share, so that the sum of Rs. 50/- per share was paid on those shares. These facts are not disputed.

3. Subsequently however, according to the respondent the first transferee transferred the 100 shares covered by the share certificate No. 1331 in favour of Badri Nara-yana Rathe (hereinafter referred to as "the second transferee"). Thereafter, the second transferee transferred the shares in favour of Harish Chandra Asthana (hereinafter referred to as "the third transferee") on 22nd May, 1950. The third transferee transferred the shares in favour of the respondent on 4-8-1950. All the aforesaid transfers, it is not disputed, were duly entered in the Share Register of the company and endorsed on the share certificate No. 1331. The respondent alleged that when in 1955. he entrusted the share certificate to M/s. Chenov Chellani & Co., a firm of share brokers of Secunderabad, for selling the same in the market after getting the shares split up and when the said brokers delivered the share scrip of 100 shares to the company with a request to issue split certificates the company informed the brokers by a letter dated, 27th September 1955, that the said share certificate had already been cancelled and fresh certificate was already issued and delivered to the third transferee. The company further retained the share certificate and declined to return the same to the brokers, intimating the brokers that the name of the respondent as the owner of the 100 shares has been removed from the share register. The respondent through his advocate sent a notice on 14-10-1955 to the company pointing out that the removal of his name from the Share Register was illegal, fraudulent and was of no legal effect. The company gave no reply to this notice.

4. The Company in its counter stated that the first transferee had asked for splitting of the share certificate bearing No. 1331 into 10 shares each and accordingly his request was granted and 10 split certificates were issued for 10 shares each in the first transferee's name. Somehow it would appear that this cancelled certificate came into the hands of the, second transferee, and presumably under a forged transfer the cancelled share certificate No. 1331 was got transferred in his name, on 14th December 1948. This transfer was approved and signed by the third transferee, a representative of the then Managing

Agents, and countersigned by N. S. Chenoy, one of the Directors. This transfer was a fraudulent transfer, though the company was unable to say who had practised this fraud on them Inasmuch as the transfer was a fraudulent one, the second transferee could not obtain any title to the share and had no right to the same. The 100 shares represented by the cancelled certificate were included in a transfer deed lodged by the third transferee for transfer of 215 shares in his name, which was approved by the third transferee himself and countersigned by N. S. Chenoy, one of the Directors and subsequently the same 215 shares out of which 100 shares are represented by the cancelled share certificate, were transferred in the name of the respondent from the third transferee, which was approved by S. M. Hpsain, a representative of the then Managing Agents of the Company and countersigned by N. S. Chenoy. The Company averred that the mistake and fraud practised on it was subsequently discovered and as such they cancelled the share, as well a certificate, which it had a right to do.

5. Satyanarayana Raju. J., posed the question for consideration as follows: Whether the company is justified in cancelling the share certificate No. 1331 and in removing the respondent's name from the Share Register. On the evidence, he held that notwithstanding the fact that it is alleged that the share-certificate No. 1331 was split on the application of the first transferee into 10 share certificates, this fact has not been noted in the register of shares and that the company continued to treat the share certificate No. 1331 as a share certificate and effected subsequent transfer, in spite of the fact, as alleged that R. W. 1 who was working in the Share Department of the company from 1st April 1950, had brought it to the notice of the Directors. Further, it was the duty of the company to verify the signature of the transfer application and to reject the transfer application if the transfer was a result of fraud: but on the other hand instead of doing so, the transfers were recognised and were duly endorsed on the share certificate. Neither the first transferee nor the second transferee has been examined and there is no evidence that these persons are not available for examination. Nor has any attempt been made to examine any of the Directors who effected the transfer nor was any explanation offered by the company for the significant omission. The action of the company in purporting to cancel the transfer five years later without notice to the respondent to show cause why the transfer should not be cancelled was unjustified. Once the transfer has been recognised, the learned Judge held, there is no provision in the Companies Act which permits the Directors of the Company or any officer of the Company to effect any alteration of the Register, And relying upon P.V. Damodara Reddi and Another Vs. Indian National Agencies, Limited, , he held that if the transfer had been improperly effected the remedy of the company was to apply to the Court u/s 38 for rectification of its register and not to take upon itself to alter the register.

6. Mr. Sankar Rao, learned counsel for the appellant company contends strenuously that the learned Judge was wrong in holding that the Company had no power to rectify the register, if it had sufficient cause to do so, which in this case it had. In support of this contention that the Directors have power to rectify

the register where the Court can under similar circumstances directed rectification, he cited *Smith v. Brown* 1896 AC 614 (PC). He further contends relying on *In re Ottos Kopje Diamond Mines Ltd.* (1893) 1 Ch D 18, that no damages can be awarded without directing rectification.

7. On the other hand, Smt. Jayashri Sarathy contends that on the evidence adduced in this case the company has failed to substantiate the foundation of the argument that the company is justified in cancelling the share certificate on the ground of fraud, mistake or misrepresentation. Secondly, assuming that the company had substantiated that argument, it is estopped from challenging the transfer which it has made notwithstanding the fact that this defect has been pointed out at the time. Consequently, the Company not having established by positive evidence that the respondent had knowledge of the illegality or fraud, the respondent could not be made to suffer. The passage of Lindley L. J., in *Ottos Kopje's case* (1893) 1 Ch. D. 18 that no damages can be awarded without rectification u/s 35 of the English Companies Act. 1862 (which corresponds to Section 38 of the Indian Companies Act, 1913) was, she contends as obiter dicta, inasmuch as only a consent order was passed in that case

8. It is true that the evidence in this case does not establish that any fraud was practised on the company. R. W. 1 who was an employee of the company in the Share Department from 1-4-1950 was speaking about the splitting of the shares on the application of the first transferee in 1946 and also of the transfer of the shares in the second transferee's name in 1948. regarding both of which he had no personal knowledge, The persons who dealt with these matters according to him, were Safdar Hussain and Narsimhulu. The former left for Pakistan in or about February 1949, and the latter died in December, 1948. No explanation was given by the company as to why when the share certificate No. 1381 was cancelled and split certificates 2276 to 2285 were issued, no entry was made of the deletion of the share certificate No. 1331 or of the issuance of the 10 split certificates in its place. By not doing so, it has itself facilitated the subsequent fraud. There is no evidence of the first or the second transferee in respect of either the splitting of the shares or of the transfer in 1948 in the name of the second transferee. The evidence of R. W. 2 a handwriting expert, has not been accepted by the learned Judge. R. W. 2 stated that he compared the signatures of the first transferee in Ex. B-2 the transfer deed executed by Lakshmi Insurance Company limited, in his favour and his signature in Ex. B-4 the transfer deed alleged to have been executed by him in favour of the second transferee, and according to him, the signatures in Exs. B-2 and B-4 of the first transferee do not tally. But as Satyanarayana Raiu J., observed and we accept that reasoning, R. W. 2 did not have the specimen signature of the first transferee for comparison. R. W. 2 further stated that he compared the signature of the second transferee in Ex. B-6, the transfer deed said to have been executed by him in favour of the respondent, and his signature in Ex. B-7 dated 22-5-1950, the transfer deed executed by the second transferee in favour of the third transferee, and found that those signatures did not tally. But even here the

second transferee's specimen signature was not before him. Be that as it may, the company has however established that it had issued the split certificates before the second transfer of the share certificate No. 1331 which is said to have been cancelled. In these circumstances, the question is whether the Court could have awarded damages without rectification, and if so, what is the measure of damages.

9. But before we consider this question, it is necessary to examine the nature of the shares and their transferability under the Companies Act. Section 28 of the Companies Act provides that the shares or other interest of any member in a company shall be moveable property, transferable in a manner provided by the articles of the company and that each share in a company having a share capital shall be distinguished by its appropriate number. It is well to remember that a share is not a sum of money, but is an interest measured by a sum of money. It is unnecessary to consider what is the right in these shares; but they are certainly moveable property. Section 29 states that a certificate issued under the common seal of the company, specifying any shares or stock held by any member, shall be prima facie evidence of the title of the member to the shares or stock therein specified. This certificate is a documentary evidence in the possession of the shareholder and though it is not a negotiable instrument, it is prima facie evidence of marketable title. The company will be estopped from denying the validity of the certificate or the registered holder thereof as having title thereto. Section 31 of the English Companies Act 1862, corresponds to Section 29 of the Indian Act. When joint stock companies were established, the object was that the shares should be capable of being easily transferred; and the legislature has made provision that by granting certificates of shares the company makes a statement that they have transferred the shares specified to the person to whom it is given, and that he is the holder of the shares. If the company is deceived at the time of transfer, though they may not be guilty of negligence they will be held to have certified the validity of the title, as no one else has power to inquire into the matter.

10. This principle has been stated clearly in *In re, Bahia and San Francisco Railway Co.* (1868) LR 3 QB 584, by both Cockburn C. J. and Blackburn J., Cockburn C. J., at p. 594, referring to the power of the company to issue certificates certifying that each individual shareholder named therein is a registered shareholder, of the particular shares specified, said; "This power of granting certificates is to give the shareholders the opportunity of more easily dealing with their shares in the market and to afford facilities to them of selling their shares by at once showing a marketable title, and the effect of this facility is to make the shares of greater value. The power of giving certificates is therefore for the benefit of the company in general; and it is a declaration by the company to all the world that the person in whose name the certificate is made out, and to whom it is given is a shareholder in the company, and it is given by the company with the intention that it shall be so used by the person to whom it is given, and acted upon in the sale and transfer of shares." Blackburn J..

agreeing with this opinion added:

"When joint stock companies were established, the great object was that the shares would be capable of being easily transferred; and the legislature has made provision by 25 and 26 Vict. C. 89, S. 25, that the company shall keep a register of the members, and when the capital is divided into shares, each share is to be distinguished by a number, and the share held by each member is to be specified and the dates at which each person's name was entered in the register. And the first thing the company would have to do when a transfer was tendered to them, would be to inquire into its validity; but a company may be deceived, and induced, as the company were in the present case without any negligence, to receive as genuine a forged transfer. They accordingly made an alteration in the register, and made in it in fact inaccurate by putting the names of Stocken and Goldner on the register as the holders of particular shares, when in fact they were not so. . . ."

Referring to Section 31 of the Companies Act (corresponding to Section 29 of the Indian Companies Act) the learned Judge further stated:

"If they (the company) have been deceived and the statement is not perfectly true, they may not be guilty of negligence, but the company and no one else have power to inquire into the matter; and it was the intention of the legislature that these certificates should be documents on which buyers might safely act."

Mellor J., and Lush J., also agreed with this view. While it is beyond dispute both on principle and authority that share certificates issued under the Indian Companies Act contain on the face of it a representation by the company that person whose name is registered thereon has title to it, and that the company would be estopped from denying his title, which if done may give rise to an action at law for damages--see (1868) LR 3 QB 584, *Balkis Consolidated Co. v. Tomkinson* 1893 AC 396 and *Hart v. Frontino and Bolivia South American Gold Mining Co.*(1870) LR 5 Ex. 111. the question would be whether such damages could be claimed on a summons or on an application u/s 38 of the Indian Companies Act (corresponding to Section 35 of the English Companies Act). Section 38 (1) and (2) of the Indian Companies Act reads thus:

" (1) If ...

(a) the name of any person is fraudulently or without sufficient cause entered in or omitted from the register of members of a company or

(b) default is made or unnecessary delay takes place in entering on the register the fact of any person having ceased to be a member the person aggrieved or any member of the company, or the company may apply to the Court for rectification of the register

(2) The Court may either refuse the application, or may order rectification of the register and payment by the company of any damages sustained by any party aggrieved, and may make such order as to costs as it in its discretion thinks

fit. . ." Mr. Sankar Rao contend? that the above provisions entitle the company for sufficient cause to rectify the register. In support of this argument, the decision in *Ottos Kopje's case*. (1893) 1 Ch. D. 18. *supra* has been pressed into service. That was a case in which the company refused to transfer the shares without further investigation but in the meanwhile, the transfer deed the certificate and the transfer fee were demanded back by and returned to the proposed transferee one Mr. Goode. Goode then moved u/s 35 of the English Company" Act. 1862 that the register of members of the company might be rectified by inserting his name therein as holder of the 4300 shares in question and that the company might be ordered to pay him the damages suffered by him by reason of their refusal to register him as a shareholder, or in the alternative that the company might be ordered to pay him the highest market value of the shares since the tender of the documents on the 6th April, 1892. One of the articles of association of the company says that all instruments of transfer shall be deposited with the company and (if required) reasonable evidence shall be given to prove the title of the transferee and thereupon the secretary shall register such transferee as a member." When the matter came up before Stirling J.. the learned Judge held that no order for rectification could be made but that the case was governed by the decision in (1868) LR 3 OB 584. *supra* the certificate purporting to be a certificate that Gardner was the owner of the specific shares, the numbers of which were given Accordingly he directed an inquiry as to what damages had been sustained by Goode in consequence of inability of the Company to register him as the transferee of the shares. The Chief Clerk accordingly assessed the damages according to the value of the shares on that day, which was accepted. Before the Appellate Court no question as to the validity of the order made by Stirling J., was raised and no appeal from that order had ever been brought. It may also be stated that before the Appellate Court for the respondent Goode. it was however stated that Stirling, .), had held in another case. *Re, Railway Time Tables Publishing Co. Ex Parte Sandys* (1889) 42 Ch. D. 98, 109 that when relief is given u/s 35, the measure of damages is to a certain extent discretionary, but that the respondent is willing to waive all further remedy at law, and to have the application treated as an action for damages at common law to which the appellants consented. Lindlev L J. dealing with (1868) LR 3 QB 584. *supra* said that that case was decided upon the footing that the company is bound by an instrument under its common seal and is estopped by the certificate from denying the validity of the shares: but to give a person who has dealt on the faith of the certificate a right of action against the company there must be some breach of duty towards him by the company. At p. 625 the learned Lord Justice said:

"A purchaser of shares can come to the Company and produce the certificate and transfer, and say. "Register me as the holder of these shares" and if the transfer is in order and the company is estopped from denying the validity of the shares, they fail in their duty towards him if they do not register him, and an action for that breach of duty will lie. Supposing that I am right, and that Goode's cause of

action was the improper refusal of the company to register him, the company could not say in answer to that. "Your transferee. Grandear, was wrongly on the register." Goode would be in a position to say to the company, "You are estopped from raising that defence, and you must register me "and if they refused there would be a breach of duty on their part which would be actionable, and in respect of which they would have to pay damages. That is the ground upon which Goods would succeed in an action at law in recovering damages from the company."

Earlier however, Lindlev, L. J., did make an observation that the Court has no jurisdiction u/s 35 of the Companies Act to direct the company to pay damages except in cases where an order is made for rectification of the Register. He said "I only make this remark because it must be borne in mind that damages without rectification cannot be obtained by a summons u/s 35 of the Act of 1862 instead of by an action at law."

11. It is contended by Smt. Jayashri Sarathy that the above statement of Lindlev L. J., was a general one and was in fact made obiter in that case. Strictly speaking u/s 35 of the English Companies Act. corresponding to Sections 38(1) and (2) of the Indian Companies Act, damages can only be ordered if the Court orders rectification of the register. Where rectification is refused, there is no question of any damages being awarded by the company under that section. No doubt in *Balkis Consolidated Company's case*, 1893 AC 396, supra it was an action at law brought to recover damages and was not an application u/s 35 of the English Companies Act, while in (1868) LR 3 QB 584, supra, the Court had u/s 35 ordered to re-store TV's name to the register and only on a case stated the question of damages arose. It is, therefore clear that it is only after rectification that the question of awarding damages would arise. The observations of Lindley L. J., were made in a case where that question would have arisen but for the fact that there was no appeal against the order of Stirling J. that no rectification could be made. Even though Lindley L. J., observed that no damages without rectification can be obtained by a summons u/s 35 of the Act of 1862 instead of by an action at law, the Appellate Court proceeded to assess the damages in view of the consent of the parties to treat it as an action at law. In our view also, whether those observations are obiter or not, they are entitled to great weight and even on a plain reading of Section 38(1) and (2) no question of damages, will arise without rectification of the register and since no rectification can be ordered, inasmuch as the shares have already been, split in 1946. the respondent M. R. . Patny's legal representatives cannot be registered as holders of the shares. In view of this conclusion, it is unnecessary for us to consider the other question, namely what is the measure of damages.

12. The result is that the appeal is allowed, the judgment of the learned Judge set aside and the application of M. R Patny is dismissed with costs here and below