

NANALAL ZAVER AND ANOTHER

v.

BOMBAY LIFE ASSURANCE CO. LTD.
AND OTHERS.[SHRI HARILAL KANIA C.J., MEHR CHAND MAHAJAN,
MUKHERJEA and DAS, JJ.]

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May 4

Indian Companies Act (VII of 1913), s. 105-C—Company—Outsider trying to get control of management by purchasing shares—Issue of further shares—Offer of new shares to existing shareholders—Validity of resolution and offer—Company in need of funds—Additional motive to prevent outsider getting control—Bona fides of resolution—Scope of s. 105-C.

A company was incorporated with a capital divided into 10,000 shares. After 5,404 shares had been subscribed, the directors of the company, finding that a businessman who had several other businesses and who was likely to use the funds of this company for his own businesses, was trying to get control of this company by purchasing its shares, resolved to issue the remaining 4,596 shares and offered these shares to the existing shareholders in the proportion of four new shares for every five shares held by them. Two of the shareholders of the company instituted a suit against the company and the directors for the following reliefs: (i) a declaration that the resolution of the directors and the offer of shares contravened the provisions of section 105-C of the Indian Companies Act, 1913, and was therefore *ultra vires* and illegal; (ii) a declaration that the offer of shares was not made *bona fide* or in the interests of the company and was therefore illegal; and (iii) to restrain the defendants from allotting any shares in pursuance of their offer:

Held per KANIA C.J., MAHAJAN, MUKHERJEA and DAS JJ.—that inasmuch as the shares resolved to be issued were offered to the existing shareholders only, and not to any outsider and these shares were also offered to the existing shareholders in proportion to the shares held by each member without making any discrimination, between them the two requirements of section 105-C were complied with and the resolution and offer did not contravene that section even though 272 shares remained undistributed as a result of the offer of four new shares for every five shares.

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Held also per KANIA C.J., MAHAJAN, MUKHERJEA and DAS JJ.—that the fact that one of the motives of the directors in issuing further shares was to prevent an outsider who had not yet become a shareholder, from getting control of the company did not render the resolution or the offer illegal inasmuch as such a motive could not in itself be said to be not in the interests of the company and even assuming that such a motive was bad this additional motive could not render the resolution and offer illegal as the company was in fact in need of further funds and it was necessary in the interests of the company to issue further shares.

Judgment of the Bombay High Court affirmed.

APPEAL from the High Court of Judicature at Bombay : (Civil Appeal No. LXIX of 1949).

This was an appeal from the judgment and decree of the High Court of Bombay dated 11th March, 1949, (Chagla C.J. and Tendolkar J.) in Appeal No. 85 of 1947, confirming a decree of the said High Court in its Original Jurisdiction dated 10th November, 1947. The facts of the case and arguments of the counsel are set out in the judgment.

N. P. Engineer (M. M. Desai and H. J. Umrigar with him) for the appellants.

M. C. Setalvad (G. N. Joshi with him) for respondents Nos. 1 to 6 and 8 and 9.

1950. May 4. The Court delivered the following Judgments :

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KANIA C. J.—This is an appeal from the decision of the High Court of Judicature at Bombay. The respondent company was incorporated in 1908 with an authorised capital of Rs. 10 lakhs divided into 10,000 shares of Rs. 100 each. By 1945, 5,404 shares were subscribed and Rs. 25 per share were called on each of them. Four thousand five hundred and ninety-six shares out of the authorised capital thus remained unissued. From about July, 1944, Mr. Padampat Singhania, a businessman interested in many companies, began to purchase shares of the company from the holders thereof on a large scale. This naturally

put up the price of the shares considerably. On the 18th September, 1944, at a board meeting of the directors the chairman drew attention of his co-directors to the attempt thus made by an outsider to corner the shares of the company. In pursuance of a resolution passed at the meeting, the chairman issued a circular to the existing shareholders acquainting them of the true position and suggesting that if they wanted to part with the shares they might get in touch with the chairman. A circular was accordingly issued with the result that two rival groups were thus offering to buy shares from those who were desirous of selling them. The shares on which about Rs. 12 or 14 were paid per annum as dividend began to be quoted in the market at about Rs. 2,000 per share in March, 1945. Mr. Singhania had not submitted to the company for registration of the transfers to his name the shares purchased by him. In the meantime on the 8th January, 1945, an application was submitted by the company to the Examiner of Capital Issues for sanction of a fresh issue of capital. Several reasons were mentioned in that application to show why the company required additional capital. Such application had become necessary owing to war regulations. The Government granted the sanction on the 16th February, 1945, and the communication was received by the company on the 20th of February. On the next day a board meeting was held at which the directors decided to issue the remaining 4,596 shares at a premium of Rs. 75 per share and to call Rs. 25 per share on them. Pursuant to this resolution a circular was issued to the shareholders on the same day with copies of the form of application and renunciation referred to in the resolution and in the circular. The shares were offered to the shareholders shown on the register of members in the proportion of four further shares for every five shares held by them. The last date for submission of the application and payment was 10th March, 1945. The directors and their friends in the next few days applied and were allotted 1,648 shares. By the 6th of March, 1945, 2,204 shares were allotted to shareholders who had applied for the same.

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The appellants are two shareholders of the company. They filed the suit, out of which this present appeal has arisen, "for themselves and all other aggrieved shareholders of the company." The defendants are the company and eight directors. It is contended in the plaint that the whole issue of these further shares and the idea of increasing the capital of the company was *mala fide* and with the object of retaining the control and management of the company in the hands of defendants 2 to 9. It is further contended that the resolution of the directors and the offer of shares contained in the circular letter were in contravention of section 105-C of the Indian Companies Act. There were further prayers restraining the company and directors from proceeding with the allotment of shares. It was contended that the company was not in need of capital and the issue of further shares was not made *bona fide* for the benefit or in the interest of the company but had been made "merely with the object of retaining or securing the second defendant and his friends the control of the first defendant company."

Considerable evidence was led in the trial Court on the question of *bona fides*. The trial Court held that the issue of new shares was *bona fide* and the appellate Court has also come to the conclusion that the object of the directors in issuing the new shares was not merely with the object of retaining or securing to the second defendant and his friends the control of the first defendant company. They held that the company was in need of capital. The suit was consequently dismissed and that decision was affirmed by the High Court on appeal.

The decision of the appellate Court has been challenged before us on both grounds. The learned counsel appearing for the appellants did not contest the concurrent finding of fact of both the lower Courts to the effect that the company was in need of capital. It was however urged on their behalf that as the issue of these shares, although not admitted in the written

statement but admitted in the course of evidence, was for the purpose of preventing the control of the company going in the hands of Mr. Singhania, the directors had not acted *bona fide* and solely in the interest of the company. I have read the judgment prepared by Das J. and I agree with his conclusion and line of reasoning on this part of the case. In my opinion, the contention of the appellants on this point was rightly rejected by both the lower Courts and that contention must fail.

That leaves the question whether the issue of these shares was in contravention of section 105-C of the Indian Companies Act. That section runs as follows:—

“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.”

On behalf of the respondents three answers were submitted. The first was that the section deals with the case of increase of capital by the directors beyond the authorised limit and as in the present case the new shares were issued within the authorized limit of capital, the section has no application. The second was that the terms of the section should be construed in a practical way and there was no difference between Regulation 42 in Table A of the Companies Act and section 105-C in respect of the scheme to offer the proportion of shares to the existing shareholders. It was argued that so long as they were offered “as nearly as circumstances admit” the directors had complied with the requirements of the section and therefore their action was not illegal. The third answer was that in fact the directors had not committed any

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breach of the terms of section 105-C up to now and therefore their action cannot be held to be illegal. In view of my conclusion on the third point it is not necessary to express any opinion on the first two answers submitted on behalf of the respondents. It seems to me that section 105-C, interpreted strictly as contended by the appellants, casts on the directors two obligations. They have to offer the shares issued to the shareholders on the register of the company and not to anyone else, and secondly, the offer must be in the same proportion to all the shareholders and there should be no discrimination amongst them. It is not contended that by the offer made by the directors to the shareholders there has been any discrimination amongst the shareholders on the register of the company. It was contended on behalf of the appellant that the directors had failed to offer all the shares resolved to be issued by them to the existing shareholders and therefore the requirements of the section had not been complied with. It was argued that the directors having resolved to issue 4,596 shares, they had to offer that whole lot at once to the shareholders on the register and the result of the offer made by them was to retain in their hands $272\frac{4}{5}$ shares. In my opinion, this contention is unsound. By their resolution of the 21st February, 1945, the directors resolved to issue 4,596 shares out of the authorized capital of the company. They have offered shares to the existing shareholders in the proportion of four new shares to five shares held by them. Inasmuch as the offer does not absorb the whole lot of 4,596 shares I am unable to construe the offer as an offer of the whole lot at once to the existing shareholders. Unless the whole lot of shares in pursuance of the offer could be accepted and taken up I am unable to consider the offer contained in the circular as an offer of the 4,596 shares. That however does not establish the contention of the appellants. I find nothing in the section to justify the conclusion that the directors must offer all the shares resolved to be issued in one lot to the shareholders. I can conceive of numerous cases where a limited company with a growing business does not

require its capital to be called up at once. For instance, soon after a company is formed it may issue shares of, say a lakh of rupees required for the construction of the buildings, and after a year when it requires further capital for payment of machinery etc. it can issue further shares. I do not think the section as worded prevents the directors from issuing shares to existing shareholders from time to time in that way. As noticed before, the object of the section is to prevent discrimination amongst shareholders and prevent the directors from offering shares to outsiders before they are offered to the shareholders. So long as these two requirements are complied with, the action of the directors in selecting the time when they will issue the shares as also the proportion in which they should be issued is a matter left to their discretion and it is not the province of the Court to interfere with the exercise of that discretion. This is of course subject to the general exception that the directors are not to act against the interest of the company or *mala fide*. No such question arises in this case and therefore it is unnecessary to discuss that aspect of the situation. In my opinion therefore on this third ground this contention of the appellants should be rejected.

The appeal therefore fails and is dismissed with costs.

MAHAJAN J.—This is an appeal by special leave from the judgment and decree of the High Court of Judicature at Bombay (Chagla C.J. and Tendolkar J.) dated 11th March, 1948, confirming the judgment of the said High Court in its Original Jurisdiction (Bhagwati J.) dated 10th November, 1947.

The two questions canvassed in this appeal are : (1) whether the issue of further shares by the directors was in contravention of the provisions of section 105-C of the Indian Companies Act, and (2) whether this issue was not made *bona fide*. Both these questions were answered in favour of the respondents by the High Court.

The Bombay Life Assurance Co. Ltd., the first defendant in the case, was incorporated in the year

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1908 as a limited company with an authorized capital of ten lakhs. Five thousand four hundred and four shares had been issued till the year 1945 and they were paid up to Rs. 25 each. The second defendant is the chairman of the board of directors which is comprised of defendants 2 to 9. The company has a life fund of Rs. 230 lakhs.

In the year 1944 Sir Padampat Singhania, an industrialist of Kanpur, attracted by the soundness of this concern, began purchasing the shares of the company with a view to acquiring a controlling interest in its management. Soon after competition started for the purchase of the shares of the company between the Singhania group and the Maneklal Premchand group who were in management of this company. The result of this competition was that shares which were ordinarily quoted at 250 went up as much as to 2,000 in March, 1945. A circular was issued by the directors to the shareholders apprising them of the activities of the Singhania party and suggesting that those who wanted to sell their shares should sell them in the first instance to the chairman. This circular does not seem to have had much effect as the shareholders wanted to reap the maximum benefit which would come to them as a result of this competition between two rich parties. By the end of December, 1944, the Singhania group had purchased 2,517 shares as against 2,397 held by Maneklal Premchand's party. The Singhania group had thus acquired a majority of the shares in the company though these had not yet been transferred in their name. On 8th January, 1945, the chairman at his own instance and after consulting some of the directors made an application to the Examiner of Capital Issues for permission for a fresh issue of capital. This was allowed on 20th February, 1945. As soon as sanction of the Examiner of Capital Issues was obtained for increasing the capital of the company, a meeting of the directors was held on 21st February, 1945, and it adopted the following resolution :—

1. That the capital of the company be increased from Rs. 5,40,400 to Rs. 10,00,000 by the issue of the

remaining 4,596 ordinary shares of Rs. 100 each at a premium of Rs. 75 per share.

2. That as on the existing shares of Rs. 100 each Rs. 25 is paid up, to call Rs. 22 per, share on these new shares also.

3. That these new shares shall rank *pari passu* in all respects with the existing shares of the company, but they shall be entitled to rank for dividend as from 1st April, 1945.

4. That these new shares shall be offered in the first instance by a circular to the shareholders of the company as shown on the register of members on 20th February, 1945, in the proportion of four new shares to every five shares held by them in the capital of the company on that date.

5. That in the case of any shareholder holding less than five shares or whose holding of shares shall not be complete multiples of five shares, then fractional certificates shall be issued to such shareholders in respect of their rights for fraction of a share, each fractional certificate representing one-fifth of a share.

6. That a sum of Rs. 100 per share (Rs. 25 towards capital and Rs. 75 for premium) shall be payable along with application for these new shares.

7. That all applications for shares in accordance with this offer (including applications for shares made in respect of and accompanied by fractional certificates and applications for shares accompanied by a renunciation) must be presented to and payment made at the registered office of the company in Bombay on or before the 10th March, 1945. Any shareholder or person in whose favour a renunciation has been signed not applying on or before the 10th March, 1945, in terms of the offer shall be deemed to have declined to participate in this new issue and all fractional certificates not presented as required on or before 10th March, 1945, will cease to have any validity and will not entitle the holder to any rights.

8. That any balance of the shares remaining out of this issue not applied for by the 10th March, 1945, shall be disposed of by the directors as they may consider best in the interests of the company.

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9. That the draft circular to the shareholders with the enclosures (form A being the form of application, form B form of renunciation and form of fractional certificates with application form) placed on the table by the manager and actuary be approved and initialled by the chairman.

10. That the manager and actuary be and is hereby directed to issue forthwith the necessary circulars to the shareholders.

11. That a committee consisting of the chairman and any one of the directors or the chairman and any two of the directors be and are hereby appointed to scrutinise the application for the new shares which may be received and to make allotment of these new shares. * * * * *

It is the validity of this resolution that is the subject matter of the present dispute. The plaintiffs, who are two shareholders of the company owing allegiance to the Singhania group, filed the suit out of which this appeal arises challenging this issue of further shares, principally on two grounds, viz. (1) that the new issue contravenes 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. As already stated, both these contentions were negatived by the trial Judge and the suit was dismissed and this decision was affirmed on appeal.

The answer to the first question depends on the meaning to be given to the words used in section 105-C of the Indian Companies Act as to its scope. The section was introduced in the Indian Companies Act in the year 1936. Antecedent to this period the question of issue of new shares by the directors was dealt with by article 42 of the Articles of Association given in the schedule to the Indian Companies Act, 1913. The article was in these terms:—

“Subject to any directions 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."

As its language indicates, the article only applied to cases where the capital of the company was increased by a resolution of the company: It had no application to cases where the directors issued further shares within the authorised limits. The new section introduced in 1936 is in these 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."

It qualifies the discretion of the directors in the matter of issue of capital by enjoining on them that if they decide to issue further shares, the existing shareholders should be given the first option to buy them. The language employed in the section admits of three possible interpretations: (1) that its scope is limited to cases where there is an increase in the capital of the company according to the provisions of section 50; (2) that the section covers within its ambit all issue of further capital whether made by increasing the nominal capital or by issuing further shares within the authorised capital; (3) that the section has application only to cases where the directors issue further shares within the authorized limit.

The learned counsel for the respondents contended that the whole intent and purpose of the section was to limit the discretion of directors in regard to the issue

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of further shares in those cases alone where there was an increase in the nominal capital of the company by recourse to the provisions of section 50 of the Indian Companies Act. It was argued that the phrase "increase of capital" has been employed by the legislature in section 50 and some other sections preceding section 105-C with reference only to the nominal capital of a company and that this expression had not been used with reference to the subscribed capital anywhere in the Act and therefore the scope of section 105-C should be limited to cases where the increase in the capital is brought about under section 50 of the Act and new shares are created and issued by the directors. In *Sircar and Sen's Indian Companies Act, 1937 Edn.* at page 309 the learned authors observe as follows:—

"The words 'further shares' must be read in conjunction with the words 'decide to increase the capital of the company.' They must mean shares which are issued for the purpose of increasing the capital beyond the authorized capital."

Mr. Ghosh on *Indian Company Law, 8th Edn.* at page 263 has stated as follows:—

"The object of this new section appears to be to make the salient provisions of Regulation 42 in Table A compulsory. The section as drafted is liable to the construction that whenever the directors decide to increase the capital of the company by the issue of further shares, even if it be a part of the authorized capital, the new shares must be first offered to the existing shareholders. But this section should be read in conjunction with clause (a) of section 50 under subsection (2) of which the directors have no power to increase the share capital of the company. Therefore it seems that the words 'further shares' mean shares beyond the authorized capital of the company."

Whatever might be the opinion expressed by these commentators, the matter has to be decided on the language of the Act itself. As already pointed out, the learned counsel for the respondents contended that the above was the correct view as to the scope of the section. The learned counsel for the appellants however urged that on a proper interpretation of the

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section its scope could not be limited only to cases of issue of further shares by creation of new shares by increasing the nominal capital of the company, but that the language employed in the section also included within its ambit cases where there was a further issue of shares by the directors, within the authorized capital. The learned counsel laid considerable emphasis on the expression "further shares" used in the section and suggested that these words have been used advisably instead of the expression "new shares" in order to bring within the scope of the section increases in the capital of a company whether within the authorised limit or outside it.

The third interpretation of the section finds support from the language employed by the legislature in the opening part of the section, wherein it is said: "Where the directors decide to increase the capital of the company by *the issue of further shares*....." The directors can only decide to increase the capital at their own initiative when they issue further shares out of the authorised capital. In no other case can the directors themselves decide as to the increase in the capital of a company. Under section 50 the capital can only be increased by a resolution of the company. Once the company has increased the nominal capital, then the directors can issue shares within the new limit. Therefore the authority of the directors, strictly speaking, in respect to the increase of capital is limited to an increase within the authorised limit. They cannot by their own decision increase the nominal capital of the company. In view of this language the third interpretation of the section seems more plausible.

The expression "capital of a company" is an ambiguous phrase and may mean either issued capital or authorized capital according to the context. It has been used in different senses in various parts of the Act. In what sense it has been used in this section is by no means an easy matter to decide, particularly in view of the fact that in spite of the introduction of this section in the Indian Companies Act in the year 1936, article 42 still remains as one of the articles to be adopted by companies if they do not choose otherwise

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and this refers to cases of increase in the nominal capital of a company. In my opinion, for the purpose of deciding the present case it is not necessary to pronounce on the question as to the precise scope of the section because I consider that on any interpretation of it the appellants' contention has to be negatived. If the interpretation suggested by the learned counsel for the respondents is accepted, then the plaintiffs' contention on the first question fails, because here there has been no increase in the capital of the company under section 50. Conceding however for the sake of argument (but not deciding) that the scope of the section is as it has been contended for by Sir Noshirwan, the question still remains "To what extent has there been a contravention of its provisions by the directors in the present case." So far as I have been able to see, the resolution passed by the directors is in accordance with the provisions of the section and does not injuriously affect the shareholders or the company, and they cannot be said to have any cause of grievance against it. In other words, in my opinion, the resolution substantially complies with the provisions of section 105-C of the Indian Companies Act. The directors offered all the new shares to the shareholders in the ratio of 4 to 5, as the shares of the company were held in multiples of five to a larger extent than in any other multiple. The result of fixing this ratio is that 272 shares remain outside the offer. In whatever other proportion the shares were offered, still a few shares were bound to remain unoffered. If a liberal interpretation is placed on the section, then it has to be held that the directors' resolution substantially complies with its provisions. On the other hand, if a technical and literal interpretation is placed on the section, then the directors were bound to offer the shares in the ratio of 4596/5404 in spite of the practical difficulties that might result in the actual working out of such a proportion, and irrespective also of whatever absurdities or anomalies might thus result. I am of the opinion that the section has to be given a workable construction and a construction that is businesslike in preference to a literal construction which might lead to a deadlock. In each

case it should be seen whether the directors have substantially complied with the provisions of the section or not.

The basic idea underlying the section is that whatever is given, is given to all the existing shareholders and is distributed equally and equitably between them. It cannot be denied that all the shareholders were offered the further shares and that they were offered equally and equitably. Whatever is the balance remains with the company with the result that the capital remains unincreased to this extent. In such a situation it is difficult to hold that the resolution passed by the directors has contravened the provisions of section 105-C and has caused any detriment or injury either to the company or to the shareholders. Even if the resolution passed by the directors is held to be in technical breach of the section, as it has caused no injury to anybody, the resolution cannot be held to be void. Under the law as it existed prior to 1936, if a company incorporated in its Articles of Association article 42 mentioned in the schedule to the Indian Companies Act, then in the case of issue of new shares the directors' discretion was curtailed inasmuch as they were bound to offer these shares in the first instance in proportion as nearly as the circumstances admitted to the amount of the existing shares to the existing shareholders but in all other cases their discretion remained unfettered. It was open to a company not to adopt article 42 and thus fetter the discretion of the directors even in the case of the issue of new capital. After 1936 it has been made obligatory on the directors to give the first option to buy further shares to the existing shareholders and without any favour to anyone. That being the intent and purpose of the section, it has been fully carried out by the directors in the present instance and has been carried out in a business-like way because the ratio in which they offered the shares is the ratio which works to the convenience of the largest number of shareholders as the shares of the company are held mostly in multiples of five. If the shares were issued in any other ratio, that would have created some difficulty in the way of shareholders who held shares in multiples of five and who owned 2,110

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shares. They would have been obliged to collect fractions before they could claim a whole share and thus make an application within the time allowed to exercise the option. Where the language of a statute in its ordinary meaning and grammatical construction leads to a manifest contradiction of the apparent purpose of the enactment, or to some inconvenience or absurdity, hardship or injustice, presumably not intended, a construction may be put upon it which modifies the meaning of the words, and even the structure of the sentence. In my opinion, the section when it says "such shares shall be offered to the members" should be construed liberally and not literally, as such an interpretation would make the section workable and would not in any way affect its intent and purpose, the phrase "such shares" meaning those shares which admit of being so offered in a businesslike way.

It was argued that a liberal interpretation of the section would result in the directors allotting the balance of shares remaining out of the further shares unoffered to their own friends and relations and it would operate to the detriment of the other shareholders. In this connection reference was made to para 8 of the resolution above mentioned. In my opinion this paragraph does not bear out the contention of the appellants because it has reference only to shares not applied for, obviously shares not offered and which could not be taken up by the shareholders cannot fall under that description. That paragraph applies only to cases where the shares could be applied for and then no application was made in respect of them. It was not disputed that the directors in the present case had not sold these shares to any one and that these have remained unissued. It was urged strongly by the learned counsel for the appellants that the section being imperative and its language being unambiguous, the Court was bound to place a literal interpretation on it and the argument of hardship or inconvenience should not weigh with it. It was further suggested that the directors could always give effect to the provisions of the section by increasing the capital in a manner and to the extent that the further shares

could be offered to the shareholders in such a proportion that all the shares offered could be taken up by them. In other words, it was contended that the section not only fetters the powers of the directors in the matter of sale of shares but it also restricts their discretion in the matter of increase of capital and as to the number of further shares. This contention, if accepted, would mean that the legislature by enacting section 105-C indirectly enjoined on the directors that whenever they decide to increase capital by issue of further shares they should make the increase only to such an extent and in a manner as to enable the existing shareholders to take the whole of it. If that was the intention of the section, there was nothing easier for the legislature to say so. The section, on the other hand, recognizes that the directors have a discretion in the matter of the increase of capital when it says, "when the directors decide to increase the capital of a company." It means that it is within their absolute discretion to take the decision whether to increase the capital or not. It is also within their discretion to say to what limit and to what extent they will increase the capital. It is also for them to decide how many shares and of what value they will issue. Once they have taken their decision, it is then and then only that section 105-C comes into operation. At that stage they have to offer the new shares to the shareholders and at that stage they can offer them in a businesslike manner to all of them equitably and equally and if out of the shares offered some cannot be taken up by the shareholders as they do not fit in the ratio in which the offer has been made, the only result is that those shares remain unoffered and thus unissued. I am therefore of the opinion that the learned Judges of the Court of appeal were right when they held that under section 105-C the shares have to be offered to the existing shareholders as nearly as the circumstances would admit and that the section has to be given a businesslike construction and should be construed liberally and that the charge of contravention of section 105-C cannot be levelled against the directors so long as they have not disposed of the unoffered balance contrary to

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the provisions of the section. The result is that the first contention of the learned counsel stands negatived.

The next question whether the action of the directors in passing the resolution was not *bona fide* seems to be concluded by concurrent findings of fact of the Courts below to the effect that the resolution was passed because the company needed additional funds at the moment when the new issue was decided upon and that the issue of shares was not due solely to the desire on the part of the directors to keep themselves in the saddle.

It is not the practice of this Court ordinarily to interfere with concurrent conclusions on questions of fact reached in the Courts below unless those conclusions have been reached on extraneous considerations or by violating rules of procedure or by committing any breach of some provision of law: vide *Srimati Bibhabati Devi v. Kumar Ramendra Narayan Roy* (1). The learned counsel for the appellants while conceding that it was not open to him to challenge concurrent findings of fact of the Courts below, urged that the whole case has been looked at by them from an erroneous angle. It was contended that the Courts below had misdirected themselves in their approach to the decision of the issue of *bona fides*. In this connection emphasis was laid on the following observations in the judgment of the learned Chief Justice and on similar observations occurring elsewhere:—

“In this particular case it is urged and urged with considerable force that the reason which actuated the directors on the 21st February, 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 a great deal. It may also be that the directors selected this particular time viz. the 21st February, 1945, for the issue of these shares because of the impending danger of the

(1) 73 I.A. 246.

majority of shares going into the hands of the Singhanina group with the necessary consequences. If, with all that, it is established before the Court that in fact on the 21st February, 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."

Reference was also made to the concluding part of the same judgment which runs thus :—

" 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 came 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."

It was argued that the learned Judges were not right in thinking that all other considerations were of

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no avail and should be practically kept out of consideration once it was established that the company needed funds. It was said that it having been found that at the time of the aforesaid resolution the directors were considerably influenced by the consideration of keeping out the Singhania group from capturing the company, and by the consideration of keeping themselves in the saddle, it should have been held that they were acting with an ulterior motive, and that their decision as to the need of the company for further funds was vitiated by reason of the ulterior motive.

It is convenient here to state what the true approach should be to a question of this nature when it arises in a case. It is well settled that in exercising their powers whether general or special, the directors must always bear in mind that they hold a fiduciary position and must exercise their powers for the benefit of the company and for that alone and that the Court can intervene to prevent the abuse of a power whenever such abuse is held proved, but it is equally settled that where directors have a discretion and are *bona fide* acting in the exercise of it, it is not the habit of the Court to interfere with them. 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 themselves and their friends in management over the affairs of the company, or merely for the purpose of defeating the wishes of the existing majority of shareholders.

It appears to me that the learned Judges in the Court below approached the decision of this question in the light of the principles stated above and the contention of the learned counsel therefore does not seem right. Where the directors are not chargeable for breach of trust so far as the company is concerned and where their action is for the benefit of the company, then merely because in promoting the interests of the company they also promote their own interests it cannot be held that they have not acted *bona fide*. As it has been said in *Hirsche v. Sims* ⁽¹⁾, if the true effect of the whole evidence is that the defendants truly

(1) (1894) A.C. 654.

and reasonably believed at the time that what they did was for the interest of the company, they are not chargeable with *dolus malus* or breach of trust merely because in promoting the interest of the company they were also promoting their own, or because they afterwards sold shares at prices which gave them large profits.

Both the Courts below have found as a fact that to a certain extent in resolving to issue new shares the directors were actuated by a fear that the Singhania group would capture the company and oust the present directors from their vantage point and take control of the company itself. It was argued that this motive was an ulterior motive and the exercise of power by the directors to achieve this objective by the issue of further shares was an exercise of power for the purpose for which it was not conferred. This argument would have had force if this was the main purpose of the directors in issuing the further shares, but this is not the case here. As found by the High Court, the central fact working in the mind of the directors was the necessity of further funds for the company at the moment they passed the resolution. That being so, it seems to me that the existence of the other motive does not make the action of the directors in respect of the issue of further shares *mala fide*.

Moreover, in the present case it seems to me that the directors were on the defensive. They felt that the attempt of the Singhania to capture the controlling interest in the company by paying high prices for its shares must have been with a purpose, *i.e.*, to make use of the funds of the company in their own concerns. Some evidence of this exists on the record. They thought that it was their duty as directors to protect the company from such an attack and they felt that it was beneficial to the company to protect it from such an attack. They did not keep the matter in secret but informed all the shareholders about it. They first attempted to enter into the field of competition with the Singhania but it seems that they were not wholly successful in their objective. They then decided to issue further capital by taking into consideration the

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interest and the needs of the company and its requirements in respect of capital at the moment. They also thought that by this action they would also be able to keep out the Singhania from capturing the company. They were under no obligation to Singhania who had not yet even been entered as shareholders on the register of shareholders. There was no *dolus malus* in their mind as directors of the company, as affecting the company or its shareholders. On the other hand, they honestly considered it to be in the best interests of the company to meet such an attack. The result therefore is that it cannot be held that this is one of those unusual cases where this Court should not give weight to the concurrent findings of fact by the Courts below, or that it is a case where it can be held that the High Court in arriving at its findings has committed a breach of any rule of procedure or law and that there is no evidence to support the findings that have been arrived at.

The result therefore is that this appeal fails and is dismissed with costs.

Das J.

DAS J.—I agree that this appeal must be dismissed. As, however, my decision rests on slightly different reasons, I desire to state them in my judgment.

For the purpose of appreciating the questions involved in this appeal which has been brought by the plaintiffs it will suffice to set out the following facts.

The Bombay Life Assurance Company, Ltd. (hereinafter referred to as "the company") was incorporated in 1908 with an authorised capital of Rs. 10,00,000 divided into 10,000 shares of Rs. 100 each. By 1945, 5,404 shares in all were subscribed, and Rs. 25 per share had been paid on them. This left 4,596 shares out of the total authorised capital yet to be issued. The plaintiffs are two of the shareholders of the company. Respondents 2 to 9 are the directors of the company of whom respondent 2 is the chairman of the board of directors. It appears that

from July, 1944, shares in the company began to be purchased from the holders thereof by or in the interest of Sri Padampat Singhania. This attempt to buy up the shares on a large scale naturally resulted in a sudden rise in the price of the shares. This abnormal rise in the price could not but attract the attention of the board of directors. On September 18, 1944, a board meeting was held at which the chairman drew the attention of his co-directors to the serious implications of the attempt of an outsider group to corner the shares of the company. It was decided at that meeting that a circular should be issued to the shareholders acquainting them of the true position and the chairman was authorised to sign the circular. Accordingly, on September 19, 1944, a circular was issued to the shareholders drawing their attention to what was happening and exhorting them, in case they wanted to dispose of their holdings, to offer them to the chairman. The result of the chairman and other directors entering the arena was a race for purchase of shares of the company which inevitably led to a phenomenal rise in the price of the shares. The shares which in 1944 were quoted at Rs. 250 per share went up to Rs. 2,000 per share in March, 1945. It may be noted here that the shares purchased by the Singhania group were not submitted for registration of the transfers with the result that their names have not yet been entered on the register of members. In the meantime, on January 8, 1945, an application was submitted by the company to the Examiner of Capital Issues for sanction for a fresh issue of capital, setting forth several reasons for which such capital was required by the company. The required sanction dated February 16, 1945, was received by the company on February 20, 1945, and on the next day (February 21, 1945) a board meeting was held at which the directors decided to issue the remaining 4,596 shares at a premium of Rs. 75 per share and to call up Rs. 25 per share on them. The minutes of the board meeting (Ex. O) are printed at pages 301-2 of the Paper Book. Pursuant to this resolution of the board a circular (Ex. Q) was issued to the shareholders on the same day with copies

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of the form of application and form of renunciation referred to in the resolution and in the circular. These further shares were offered to the shareholders shown on the register of members in the proportion of four further shares to every five shares then held by them. The last date for submission of the applications and necessary payments for the shares so offered was fixed for March 10, 1945. It is said that on the very next day after the board meeting 1,648 shares were allotted and that between February 22, and March 6, 1945, 2,204 shares were allotted to the shareholders who had applied for the same. The suit out of which the present appeal has arisen was filed on March 5, 1945.

The plaintiffs are two of the members of the company suing "for themselves and all other aggrieved shareholders" of the company. The defendants are the company and the eight directors. The reliefs prayed for are as follows, *inter alia* :

(a) That it may be declared that the resolution of the directors and the offer referred to in para 6 hereof contravenes the provisions of section 105-C of Indian Companies Act and was and is *ultra vires*, and illegal ;

(b) That it may be declared that the said offer of shares referred to in para 6 hereof is not *bona fide* or in the interest of the defendant company and is *ultra vires* and illegal ;

(c) That the defendants 2 to 9 may be restrained by an injunction from allotting any shares or doing any further act in pursuance of the said offer."

It will be noticed that none of the shareholders other than the directors to whom further shares had been allotted before the filing of the suit has been made a party to the suit. Further, even as against the defendants 2 to 9 the consequential relief by way of cancellation of the allotments of further shares to them and the rectification of the register in respect thereof has not been prayed for by the plaintiffs.

The contentions of the plaintiffs as set forth in the plaint on which the above prayers were founded may be summarised shortly as follows :

(i) the company was not in need of capital,
 (ii) the issue of further shares was not made *bona fide* for the benefit or in the interest of the company but had been made "merely with the object of retaining or securing to the second defendant and his friends the control of the first defendant company," and

(iii) the issue and offer of further shares are illegal and void for contravention of the provisions of section 105-C of the Indian Companies Act. It is necessary to examine each of these contentions and to ascertain their effect.

Re (i): Both the Courts below have found it as a fact that at the time the directors resolved upon the issue of further shares the company was in need of capital for the purposes mentioned in the company's application to the Examiner of Capital Issues referred to above. This concurrent finding of fact has not been contested before us and the next contention of the appellants will have to be examined in that light.

Re (ii): It is not disputed that the company's need for funds standing by itself will afford a good motive to the directors to issue further shares. The contention, however, is that if that motive was not the sole motive but was mixed up with any other motive, it was an abuse of the powers of the directors to issue further shares. This plea is clearly a departure from the case made in the plaint. There the case was that there was no need for funds at all and the *sole* motive of the directors was *merely* to retain their own control over the affairs of the company. It will, however, be a hypertechicality to shut out this plea altogether. The plea of mixed motive raises three questions, namely—

(a) whether apart from the motive of finding further capital for the company, there was any, and, if so, what other motive,

(b) was that other motive vitiated by bad faith, and

(c) if it was so vitiated, whether the presence of it nullified the good motive and rendered the issue of further shares illegal and void.

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The contention of the plaintiffs before Bhagwati J. as before us, was that the company was not in need of any further capital in February, 1945, and that the directors of the company decided to issue the further capital *merely* with a view to retain control of the management of the company in their hands. On the evidence before him, Bhagwati J. found that the motive of the directors was rather to keep the Singhanias group out of the control of the company than to retain their own control. The race for the purpose of purchasing the shares was not merely for the purpose of increasing their holdings for holdings' sake but was really with a view to prevent the Singhanias group from obtaining a majority of shares which would give them the control of the management of the company and enable them to utilise the life funds of the company for the purposes of the various industrial concerns of the Singhanias group. The result of keeping out the Singhanias group might well be to strengthen the position of the directors and to keep them in the saddle, but the proximate motive was to exclude the Singhanias. The distinction is real and quite understandable. The appeal Court does not appear to have dissented from this view of the matter and I do not see any reason to take a different view. It follows, therefore, that apart from the motive of raising fresh capital for the purposes and benefit of the company, the directors also had another motive, namely, to prevent the Singhanias group, who are strangers to the company, from intruding into its affairs so as to be able to assume a controlling hand in its management for their own purposes rather than for the benefit of the company. On the evidence on record the existence of this motive side by side with the motive of raising further capital cannot be denied.

The question then arises whether in acting up to it the directors were actuated by bad faith. In coming to a conclusion on this point it has to be borne in mind that the Singhanias group had only purchased some shares from various existing shareholders but did not submit the transfers of registration so as to get their names put upon the register of members: It is clear that until the Singhanias group get their names

entered in the register of members, they are not shareholders but are complete strangers to the company. It has been held in *Percival v. Wright*⁽¹⁾ that ordinarily the directors are not trustees for individual shareholders. Even if the directors owe some duty to the existing shareholders on the footing of there being some fiduciary relationship between them as stated in some cases [see for example *In re Gresham Life Assurance Society*]⁽²⁾, I see no cogent reason for extending this principle and imputing any kind of fiduciary relationship between the directors and persons who are complete strangers to the company. In my judgment, therefore, the conduct of the respondents 2 to 9 cannot be judged on the basis of any assumed fiduciary relationship existing between them and the Singhanian group. In my opinion, the respondents 2 to 9 owed no duty to the Singhanian group and, therefore, the motive to exclude them cannot be said to be *mala fide per se*. In *North-West Transportation Company, Ltd. v. Beatty*⁽³⁾ the Judicial Committee observed at p. 601 :

“ But the constitution of the company enabled the defendant J.H. Beatty to acquire this voting power ; there was no limit upon the number of shares which a shareholder might hold, and for every share so held he was entitled to vote, the charter itself recognised the defendant as a holder of 200 shares, one-third of the aggregate number ; he had a perfect right to acquire further shares, and to exercise his voting power in such a manner as to secure the election of directors whose views upon policy agreed with his own, and to support those views at any shareholders’ meeting.”

Beatty referred to in the above passage was a director. It follows therefore, that the fact of the directors entering into a competition with the Singhanian group in purchasing the shares of the company was quite legitimate and was not *mala fide*. It was urged, however, that the issuing of further shares, although the company required further capital, was, in the circumstances, evidence of bad faith. Bhagwati J. dealt

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(1) L.R. (1902) 2 Ch. 421. (2) L.R. 8 Ch. App. 446 at p. 449.

(3) L.R. 12 A.C. 589.

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with the various acts of the directors relied upon by the plaintiffs as indicating bad faith on the part of the directors and on a consideration of all of them was "unable to come to the conclusion that the issue of new shares was decided upon by the directors not *bona fide* in the interests of the company and merely with a view to keep the control of the affairs of the company in their hands." The learned Judge, therefore, came to the conclusion that the issue of further shares and the offer thereof made on the 21st February, 1945, was not *ultra vires* and illegal. Some of these facts on which the charge of *mala fide* was sought to be founded were urged before the appeal Court by learned counsel for the appellants. The learned Chief Justice discussed the matters and concluded by saying that he agreed with the trial Judge that the plaintiffs had 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, and for the benefit, of the company. I do not see any cogent reason for taking a different view on the facts. The position, shortly put, was that the Singhania group, who were outsiders and to whom the directors owed no duty, were out to corner the shares of the company for their own ends. To thwart that object of the Singhania group by making it more and more difficult for them to acquire more shares the directors took advantage of the existing needs of the company for further capital and decided upon to issue further shares. The issue of further shares served two purposes, namely, the purpose of finding the necessary finance, and to exclude the interlopers, both of which purposes, according to the directors, were for the benefit of the company. Rightly or wrongly, the directors felt that it was not in the interests of the company to allow the Singhania group a controlling hand in the management of the affairs of the company. Their apprehension evidently was that the Singhania group, if and when they became shareholders, would use their voting power in their own interests and to the detriment of the company by utilising the life fund of the company for the purposes of their various other industrial concerns. I find nothing in the evidence on

record to doubt the honesty of the directors in holding this view and, that being so, I see nothing improper if the directors in the interests of the company and the existing shareholders tried to prevent what, according to them, would be a catastrophe. Indeed, if the directors honestly held that view—and as already stated I have no reason to think that they did not—they would, in my opinion, have been guilty of dereliction of duty to the company and to the existing shareholders if they did not exert themselves to prevent such evil. In my judgment the motive to prevent the Singhanian group, who were outsiders, from acquiring a control over the company cannot, as between the directors and the company and the existing shareholders, be stigmatised as *mala fide*.

At two places in his judgment the learned Acting Chief Justice expressed the view that if it were established before the Court that the company needed further capital, all other considerations could be of no avail or of very little avail as against that central fact. Tendolkar J. did not consider it necessary to deal with the various acts of the directors relied upon as evidence of their *mala fides*, because he was of the view that assuming that the directors did all those acts with the object of keeping the Singhanian group out of control of the company, the moment it was 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 did not render the issue of further capital either *ultra vires* or invalid. Learned counsel for the plaintiffs contends that the learned Judges in the Courts below entirely overlooked the point that the presence of such bad motive would nullify the good motive of finding capital necessary for the company and this mixture of motives would render the issue of further shares illegal and void. This leads me to a consideration of the third sub-head on the assumption that what I have called the additional motive was a bad motive.

It is well established that directors of a company are in a fiduciary position *vis-a-vis* the company and

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must exercise their power for the benefit of the company. If the power to issue further shares is exercised by the directors not for the benefit of the company but *simply and solely* for their personal aggrandisement and to the detriment of the company, the Court will interfere and prevent the directors from doing so. The very basis of the Court's interference in such a case is the existence of the relationship of a trustee and of *cestui que trust* as between the directors and the company.

The first case to be referred to is that of *Fraser v. Whalley*⁽¹⁾. In that case a new company was incorporated in 1859 by an Act of Parliament. By that Act also certain existing railway companies were authorised "to acquire, take and hold shares in the undertaking of the company, and *for such purpose* to create new shares in their undertakings." The existing companies in 1861 passed resolutions authorising their directors to exercise this power. The resolutions were, however, not acted upon and the existing companies did not issue new shares in their undertakings for the purpose of taking up any share in the new company and all the shares of the new company were issued to persons other than the existing companies. In short, the shares which it was contemplated would be taken up by the existing companies were no longer available. Subsequently, in 1862, another Act of Parliament was passed authorising the new company to make a branch line and for that purpose to raise fresh capital by the creation and issue of new shares. But this new Act gave no fresh power to the existing companies to take up any of these new shares to be issued by the new company. One Savin held the majority of shares in the existing companies and there was dispute between him and the directors. The general meeting of the company was shortly going to be held and the directors knew that at the ensuing general meeting their policy would be repudiated by the majority of shareholders and they would be turned out from their office. It was in these circumstances that the directors purporting to act on the resolutions of

(1) (1864) 2 H. & M. 10.

1861, resolved to issue new shares. Suit was filed on behalf of the shareholders to restrain the directors from issuing any new shares. On a motion for injunction Wood V. C. granted an interlocutory injunction. In course of his judgment the learned Judge observed :

“The directors are informed that at the next general meeting they are likely to be removed, and, therefore, on the very verge of a general meeting, they, without giving notice to anyone, with this indecent haste and scramble which is shewn by the times at which the meetings were held, resolve that shares are, on the faith of this obsolete power entrusted to them for a different purpose, to be issued for the very purpose of controlling the ensuing general meeting.

I have no doubt that the Court will interfere to prevent so gross a breach of trust. I say nothing on the question whether the policy advocated by the directors, or that which I am told is to be pursued by Savin, is the more for the interest of the company. That is a matter wholly for the shareholders. I fully concur in the principle laid down in *Foss v. Harbottle* (2 Hare, 461) as to that, but if the directors can clandestinely and at the last moment use a stale resolution for the express purpose of preventing the free action of the shareholders, this Court will take care that, when the company cannot interfere, the Court will do so.”

It will be noticed that this decision proceeds entirely on the grounds that the resolutions of 1861 on which the directors purported to act were obsolete, for they had not so long been acted upon and also because the shares contemplated by that resolution were not available, and that even if the resolutions were still effective and gave authority to the directors to issue new shares, the directors could only do so for the purpose of acquiring shares in the new company and not for the purpose of controlling the ensuing general meeting and preventing the free action of the shareholders. There was no evidence whatever in that case that the issue of shares was at all for the benefit of the company. The issue of shares in that case was not for the purpose of taking up shares in the new company for which purpose alone the power could be exercised,

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but that it was being exercised, *wholly and solely* for quite a different purpose, namely, of maintaining themselves in office.

Punt v. Symons & Co. Limited ⁽¹⁾ was a motion for an interim injunction to restrain the holding of a meeting of the defendant company for confirming the resolution for issue of shares. On the evidence it was quite clear "that these shares were not issued *bona fide* for the general advantage of the company, but that they were issued with the immediate object of controlling the holders of the greater number of shares in the company, and of obtaining the necessary statutory majority for passing a special resolution while, at the same time, not conferring upon the minority the power to demand a poll." Byrne J. granted an injunction restraining the defendant from holding the confirmatory meeting and observed:

"I am quite satisfied that the meaning, object, and intention of the issue of these shares was to enable the shareholders holding the smaller amount of shares to control the holders of a very considerable majority. A power of the kind exercised by the directors in this case, is one which must be exercised for the benefit of the company; primarily it is given them for the purpose of enabling them to raise capital when required for the purposes of the company. There may be occasions when the directors may fairly and properly issue shares in the case of a company constituted like the present for other reasons. For instance, it would not be at all an unreasonable thing to create a sufficient number of shareholders to enable statutory powers to be exercised, but when I find a limited issue of shares to persons who are obviously meant and intended to secure the necessary statutory majority in a particular interest, I do not think that is a fair and *bona fide* exercise of the power."

The learned Judge concluded with the following words:

"If I find as I do that shares have been issued under the general and fiduciary power of the directors for the express purpose of acquiring an unfair majority

(1) L.R. [1903] 2 Ch. 506.

for the purpose of altering the rights of parties under the articles, I think I ought to interfere."

Piercy v. S. Mills & Co. Ltd. (1) was a witness action before Peterson J. It was indeed a gross case. On the evidence Peterson J. found that it was manifest "that the shares were allotted *simply and solely* for the purpose of retaining control in the hands of the existing directors." After stating the facts, the learned Judge said :

"The question is whether the directors were justified in acting as they did, or whether their conduct was a breach of the fiduciary powers which they possessed under the articles. What they did in fact was to override the wishes of the holders of the majority of the shares of the company for the time being by the issue of fresh shares issued *solely* for that purpose."

Then after referring to *Fraser v. Whalley* and *Punt v. Symons & Co. Ltd.* (supra), the learned Judge concluded :

"The basis of both cases is, as I understand, that directors are not entitled to use their powers 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, or *merely* for the purpose of defeating the wishes of the *existing majority* of shareholders. That is, however, exactly what has happened in the present case. With the merits of the dispute as between the directors and the plaintiff I have no concern whatever. The plaintiff and his friends held a majority of the shares of the company, and they were entitled, so long as that majority remained, to have their views prevail in accordance with the regulations of the company, and it was not, in my opinion, open to the directors, for the purpose of converting a minority into a majority, and *solely* for the purpose of defeating the wishes of the existing majority, to issue the shares which are in dispute in the present action."

In the result, the shares allotted to the defendants were declared void.

(1) L.R. [1920] 1 Ch. 77.

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It will be noticed that in each of the three cases the act of the directors was not only not of advantage to the company but was in essence to its detriment in that it was calculated to reduce the *existing majority* into minority and to prevent the majority of the *existing shareholders* from exercising their discretion with respect to what they conceived to be in the best interests of the company. Those cases were not cases of mixed motives at all. The only motive operating in those cases in the minds of the directors was detrimental to the interests of existing shareholders and, therefore, to the company itself. Our attention was drawn to Palmer's Company Law, 18th Edition, p. 183, where it is stated that "in exercising their powers, whether general or special, directors must always bear in mind that they are in a fiduciary position, and must exercise their powers for the benefit of the company, and for that alone." Relying on the words "and for that alone," it is urged that the power to issue shares must be exercised *wholly and solely* for the benefit of the company, that there must not be any other motive whether or not that other motive is injurious to the company and that if that power is exercised for that purpose and also for some other purpose then irrespective of the nature of that other purpose the directors would be guilty of an abuse of their power. I am not prepared to read the passage in the way urged by learned counsel for the plaintiffs. None of the cases cited on that point in Palmer's Company Law was concerned with mixed motives at all. In none of them was there any motive beneficial to the company or to the existing shareholders. In my view what that passage means is that the power must be exercised for the benefit of the company and that as between the directors and the company there must be no other motive which may operate to the detriment of the company. If the directors exercise the power for the benefit of the company and at the same time they have a subsidiary motive which in no way affects the company or its interests or the existing shareholders then the very basis of interference of the Court is absent, for, as I have pointed out, the Court of equity only intervenes in order

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to prevent a breach of trust on the part of the directors and to protect the *cestui que trust*, namely the company and possibly the existing shareholders. If as between the directors and the company and the existing shareholders there is no breach of trust or bad faith there can be no occasion for the exercise of the equitable jurisdiction of the Court. I find support for my views in the following observations of their Lordships of the Judicial Committee in *Hirsche v. Sims*⁽¹⁾:

“ If the true effect of the whole evidence is, that the defendants truly and reasonably believed at the time that what they did was for the interest of the company, they are not chargeable with *dolus malus* or breach of trust merely because in promoting the interest of the company they were also promoting their own, or because they afterwards sold shares at prices which gave them large profits.”

On the facts of this case the concurrent finding is that the company was in need of funds and, therefore, the issue of further shares was clearly necessary and is referable to such need. The further motive of keeping out the Singhanian group, who are not yet shareholders but are strangers, does not prejudicially affect the company or the existing shareholders and the presence of such further motive cannot vitiate the good motive of finding the necessary funds for the company. In my judgment it is impossible to hold that the issue of fresh shares was, in the circumstances, illegal or void.

Re (iii):—Learned counsel for the plaintiffs contends that both the Courts below were in error in holding that there has been no contravention of the provisions of section 105-C of the Indian Companies Act. That section 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

(1) [1894] A.C. 654, at pp. 660-661.

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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."

This section was added to the Indian Companies Act in 1936.

The first question is whether the section contemplates increase of capital above the authorised limit, or only below the authorised limit. Learned Attorney-General appearing for the company urges that the words "further shares" must be read in conjunction with the words "decide to increase the capital of the company" and, so read, must mean shares which are issued for the purpose of increasing the capital beyond the authorised capital. He contends that section 105-C has no application to this case. Section 50 deals with, among other things, alteration of the conditions of the Memorandum of Association of the company by increasing its *share capital* by the issue of *new* shares. The very idea of alteration of the memorandum by the issue of *new* shares clearly indicates that it contemplates an increase of the *share capital* above the authorised capital with which the company got itself registered. This increase can only be done by the company in a general meeting as provided in sub-section (2) of section 50. This increase above the authorised limit cannot possibly be done by the directors on their own responsibility. Section 105-C, however, speaks of increase of *capital* by the issue of *further* shares. The words used are *capital* and not *share capital* and *further* shares and not *new* shares. It speaks of increase by the directors. Therefore, the section only contemplates such increase of capital as is within the competence of the directors to decide upon. It clearly follows from this that the section is intended to cover a case where the directors decide to increase the capital by issuing further shares within the authorised limit, for it is only within that limit that the directors can decide to issue further shares, unless they are precluded from doing even that by the regulations of

the company. It is said that section 105-C becomes applicable after the company in a general meeting has decided upon altering its memorandum by increasing its share capital by issuing new shares. If the company at a general meeting has decided upon the increase of its share capital by the issue of new shares, then it is wholly inappropriate to talk of the directors deciding to increase capital, because the increase has already been decided upon by the company itself. Further, after the company has at a general meeting decided to increase its share capital by the issue of new shares, the increased capital becomes its authorised capital and then if the directors under section 105-C decide to increase the capital by the issue of *further* shares, then this decision is nothing more than a decision to raise capital within the newly authorised limit. Finally, if section 105-C were to be held applicable to the case of an increase of capital above the authorised limit then such construction will lead to anomalous results so far as the companies which have adopted Table A, for the section is not consonant with Regulation 42 of Table A which, as will be shown hereafter, applies to increase of capital beyond the authorised limit. If the Legislature intended that section 105-C should apply to all companies in the matter of increase of capital above the authorised limit, then the simplest thing would have been to make Regulation 42 a compulsory regulation, instead of introducing a section which in its terms differs from Regulation 42 and which therefore makes the position of companies which have adopted Table A anomalous. It appears to me, therefore, for reasons stated above, that section 105-C becomes applicable only when the directors decide to increase capital within the authorised limit by the issue of further shares. In this view of the matter that section is clearly applicable to the facts of this case.

The next question is whether the directors have, in the matter of issuing and offering further shares in the present case, been guilty of any contravention of the provisions of this section. Learned counsel for

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the plaintiffs contends that they have, because they have not offered the whole lot of shares to the shareholders in proportion to the existing shares held by them. It is pointed out that although the directors decided to issue 4,596 further shares they have only offered four shares to every five shares held by the shareholders which works out at $4,323\frac{1}{5}$ shares which leaves $272\frac{4}{5}$ shares in the hands of the directors which they have reserved power unto themselves to dispose of in such manner as they think fit. Learned Attorney-General appearing for the company submits :

(a) That section 105-C should be construed in the light of Regulation 42 in Table A of the Indian Companies Act, 1913 ;

(b) That in order to prevent absurdity and to give business efficacy to the section, the words " as nearly as circumstances admit " should be read into the section ; and

(c) That in any event the directors have not contravened the provisions of the section even if the same be literally construed.

Each of these points requires serious consideration.

As to the first point it should be remembered that section 105-C was introduced in the Act only in 1936. There is no counterpart of it in the English Act even now. Prior to 1936 there was no check on the powers of the directors to issue blocks of shares, within the authorised limit, to themselves or to their nominees, unless their powers were circumscribed by the Articles of Association. One of the mischiefs of the managing agency system which prevails in this country was that the managing agents, who usually dominated the board of directors, could, to secure their own position, induce the board to issue blocks of preference shares to the managing agents or their nominees. To check this mischief section 105-C was introduced in the Indian Act in 1936. As regards the increase of capital beyond

the authorised limit it could only be done by the company. The shareholders could, while sanctioning such increase, protect themselves by giving special directions to the directors as to the mode of disposal of the new shares. In the model Regulations set forth in Table A of the 1882 Act under the heading "Increase of Capital" are grouped three Regulations 26 to 28. Regulation 27 was in the following terms :

" (27) Subject to any directions to the contrary that may be given by the meeting that sanctions the increase of capital, all new shares shall be offered to the members in proportion to the existing shares held by them, 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 the 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."

In Table A of our present Act under the heading "Alteration of Capital" are to be found three corresponding Regulations 41 to 43. Regulation 42 is as follows :—

" (42) 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

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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.*"

The words underlined are new and are not to be found in Regulation 27 of Table A of the 1882 Act. The scheme of the 1882 Act, as of our present Act, and the language used in the two regulations quoted above clearly indicate, to my mind, that they deal with that kind of increase of share capital which involves an alteration of the conditions of the memorandum which the company alone can do by issuing new shares. These Regulations do not purport to deal with increase of capital which is within the competency of the directors to decide upon. In that kind of increase of capital beyond the authorised limits these regulations give the directors certain latitude, subject, of course, to any directions to the contrary that may be given by the resolution of the shareholders in general meeting sanctioning such increase. The only difference between Regulation 27 of 1882 and Regulation 42 of our present Act is that under the last mentioned Regulation, in the absence of any direction to the contrary, the discretion of the directors has been widened by the introduction of the words underlined above. This company was incorporated in 1908 under the Act of 1882. It did not adopt the Regulations of Table A of the 1882 Act but article 45 of its Articles of Association proceeds more or less on the lines of Regulation 27 of Table A of the 1882 Act. The discretion given to the directors under article 45 is, therefore, obviously narrower than that left to the directors under Regulation 42 of Table A of the present Act. Then came section 105-C in 1936. As already pointed out, that section deals with increase of capital within the authorised limit which the directors can decide upon without reference to the shareholders in a general meeting of the company. The legislature had before it both Regulation 27 of Table

A of 1882 and Regulation 42 of Table A of the Act of 1913. It chose to adopt the language of Regulation 27 in preference to that of Regulation 42. The absence in section 105-C of the words I have underlined in Regulation 42 cannot but be regarded as deliberate. And I can conceive of very good reasons for this departure. In the case of increase beyond the authorised limit, that can be done only by the company in general meeting and the shareholders can protect themselves by giving directions to the contrary and, therefore, subject to such directions a wider latitude may safely be given to the directors. But in the case of increase of capital within the authorised limit which the directors may do without reference to the shareholders the legislature did not think it safe to leave an uncontrolled discretion to the directors. The mischief sought to be remedied required this curtailing of the directors' discretion. In my judgment it is impossible to construe section 105-C in the light of Regulation 42 for several reasons. Regulation 42 and section 105-C do not cover the same field and cannot be said to be *in pari materia*. The omission of the underlined words was obviously deliberate. The difference in the language of the two provisions in the same statute cannot be overlooked as merely accidental. And lastly the reading of these words of Regulation 42 in section 105-C will frustrate what I conceive to be the underlying reason for the introduction of the section. In my judgment the first point urged by the learned Attorney-General which found favour with the Courts below cannot be accepted.

The second point urged by the learned Attorney-General is founded on the supposed necessity of introducing the words "as nearly as the circumstances admit" to avoid the absurdity which may flow from a literal construction of section 105-C. It must be remembered that the cardinal rule of interpretation of statutes is to construe its provisions literally and grammatically giving the words their ordinary and natural meaning. It is only when such a construction leads to an obvious absurdity which the legislature cannot be supposed to have intended that the Court in

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interpreting the section may introduce words to give effect to what it conceives to be the true intention of the legislature. It is not any and every inconvenience that justifies adoption of this extreme rule of construction. The section literally construed is quite intelligible and may easily be applied to many cases where the further shares issued bear a uniform and round proportion. Merely because a literal construction of the section leads to inconvenient result in a particular case cannot, in my opinion, justify the application of such a drastic rule of construction as is urged by the Attorney-General. Even in this case there would have been no inconvenience if the directors decided for the issue of 4,053 shares which could have been offered in the proportion of three shares to every four shares held by each shareholder. It is true that ordinarily it is for the directors to judge as to the exact amount of capital needed by the company but in arriving at their decision they cannot overlook the limitations put upon their power by the section with respect to the proportion in which the further shares are to be offered by them to the shareholders. Further, the supposed inconvenience can be easily avoided by a reference to the shareholders in a general meeting by asking them to increase the share capital beyond the authorised limit to such an amount as would permit proportionate disposal of the further and new shares. In my opinion there is not sufficient force in the contention which should induce the Court to depart from the ordinary and golden rule of interpretation I have mentioned above.

The last point urged by the learned Attorney-General appears to me to be of substance. On a strictly literal construction of the section the directors must perforce offer all the further shares to the shareholders in proportion to their respective holdings. Section 105-C comes into operation after the directors have decided to issue further shares. The section does not in terms provide that such offer must be made all at once or at any particular point of time and I see no reason to import any such requirement in the section.

The underlying object of the section is to effect equitable distribution of the further shares. Here the shares have been offered in the proportion of four shares to every five shares. There can be no suggestion of favouritism in this offer. Every shareholder will get his proportion if he so desires. The majority will remain the majority if every one takes up the shares offered to him. It is true that 272-4/5 shares remain in hand. At best although issued they have not been offered to anyone. I do not agree that under clause 8 of the directors' resolution the directors can dispose of those 272-4/5 shares in any manner they please before offering them proportionately to the existing shareholders. That clause, on a true construction of the resolution as a whole, covers only those shares which have been actually issued but have not been applied for. In point of fact the directors have not yet allotted any of these 272-4/5 shares. If and when the directors allot these shares otherwise than in due course of law, i.e., without offering them to the shareholders, the shareholders will then have cause for complaint and may then come to Court for redress. It is said that 272-4/5 shares cannot in future be offered to so many shareholders in a reasonable proportion. If it cannot be done, these odd shares will remain in hand until the company at a general meeting decides to increase the share capital by issuing *new* shares and then these odd shares together with new shares will be easily capable of being offered to the shareholders proportionately. These special considerations which arise in the case of this company by reason of its own peculiar circumstances cannot, in my opinion, affect or alter the meaning and effect of the section. From all that I can see, up to the present time, there has been no contravention of the provisions of section 105-C. In my view the directors have substantially complied with the requirements of the section and the plaintiffs can have no grievance. They rushed to Court prematurely.

For the reasons stated above, I am clearly of opinion that the conclusions of the Courts below were

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right and no ground has been made out for interfering with the same. The result, therefore, is that this appeal is dismissed with costs.

MUKHERJEA J.—I agree that this appeal should be dismissed and I concur substantially in the reasons which have been given by my learned brother Mr. Justice Das in his judgment.

Appeal dismissed.

Agent for the Appellants: *S. P. Varma.*

Agent for the Respondents: *Rajinder Narain.*
