LL.B. III Term

Company Law

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LL.B. III Term

LB – 303: COMPANY LAW

Prescribed Legislation: The Companies Act, 2013 (as amended)

Prescribed Readings:

Paul L. Davies and Sarah Worthington, ***Gower's Principles of Modern Company Law*** (10th ed., 2016/Latest edition)
A. Ramaiya, ***Guide to the Companies Act*** (19th ed., 2020/Latest edition)
Hicks, Andrew & Goo S H, ***Cases and Material on Company Law,*** Oxford University Press (8th ed., 2008/Latest edition)
Kershaw, David, ***Company Law in Context***, Oxford University Press, UK, (2nd ed., 2012/Latest edition)
Avtar Singh, ***Company Law*** (17th ed., 2018/Latest edition)
H.K. Saharay, ***Company Law*** (7th ed., 2016/Latest edition)

Prescribed Journals:

Chartered Secretary: ICSI, New Delhi
Corporate Law Adviser
Company Law Journal

Recommended Readings:

- ***Report of the Company Law Committee, 2019***
- ***BAXI, U. (2016). Human Rights Responsibility of Multinational Corporations, Political Ecology of Injustice: Learning from Bhopal Thirty Plus? Business and Human Rights Journal, 1(1), 21-40. doi:10.1017/bhj.2015.7***

Topic 1 : Nature and Kinds of Companies

(a) '***Company'*** – Historical Evolution of Company Law in India*;* Meaning and Nature of Company Definition [Section 2(20)]; Registration of company [Sec 9]; Comparison between Company and Partnership and Company and Limited Liability Partnership.

(b) ***Theory of 'Corporate Personality'***; Concept of Separate Legal Entity, Company not a citizen of India; Lifting of the Corporate Veil, Statutory Exceptions to Limited Liability.

1. *Salomon* v. *Salomon & Co., Ltd.* (1897) A.C. 22 (H.L.): (1895-95) All ER Rep. 33
2. *Bennett Coleman & Co. & Ors v. Union Of India & Ors,* (1972) 2 SCC 788
3. *Daimler Co., Ltd.* v. *Continental Tyre and Rubber Co. (Great Britain), Ltd.,* 1916 AC 307: (1916-17) All ER Rep. 191
4. *Lee* v. *Lee's Air Farming, Ltd*. (1960) 3 All E.R. 420
5. *In re Sir Dinshaw Maneckjee Petit,* AIR 1927 Bom. 371
6. *Workmen v. Associated Rubber Industries Ltd. (1985) 4 SCC 11: (1986) 59 Comp. Cas. 134 (SC)*
7. *Gilford Motor Co., Ltd. v. Horne (1933) 1 Ch. 935*
8. *Subhra Mukherjee v. Bharat Coking Coal Ltd. (2000) 3 SCC 312*

(c) ***Kinds of Companies*** – Public Sec.2(71) and Private Companies Sec.2(68); Holding Sec.2(46) and Subsidiary Companies Sec.2(87); Limited and Unlimited Companies Sec.2(92); Share-holding and Guarantee Companies Sec.2(21/22); Small company Sec.2(85); One person company Sec.2(62);

Government company Sec.2(45); and foreign company Sec.2(42).

Reference/Suggested Cases

- *State Trading Corporation* v. *CTO, AIR 1963 SC 811*
- *TELCO* v. *State of Bihar, AIR 1965 SC 40*
- *R.C. Cooper* v. *Union of India (1970) 3 SCR 530*
- *CIT* v. *Meenakshi Mills Ltd., AIR 1967 SC 819: (1967) 1 SCR 934*
- *Kapila Hingorani* v. *State of Bihar (2003) 6 SCC 1*

Topic 2 : Promotion and Formation of Company

(a) ***Promotion:*** Promotion of Company, Promoters Sec.2 (69), their position, Powers, Duties and Liabilities.
(b) ***Formation:*** Formation of Company (Sec.3), Procedure of registration including online registration of a company, Effects of Certificate of Incorporation and Registration of company (Sec.9).

9. Erlanger v. *New Sombrero Phosphate Co.* (1878) 3 AC 1218: (1874-80) All ER Rep. 271

Topic 3 : Company's Constitutional Documents

(a) ***Memorandum of Association*** **Section 4** ***and Articles of Association*** **Section 5** – Importance, Registration and Its Effect; Binding Nature; Clauses in Memorandum of Association, Alteration of Memorandum of Association and Articles of Association **Section 10-16**

(b) ***Doctrine of Ultra vires*** – A Critical Analysis of doctrine of Ultra Vires.

10. Ashbury Railway Carriage and Iron Co. Ltd. v. *Riche* (1875) L.R.7 H.L.: (1874-80) All ER Rep. 2219 (HL)

11. Cotman v. *Brougham,* (1918-19) All ER Rep. 265 (HL)

12. In re (Jon) Beuforte (London) Ltd. (1953) Ch. 131

13. Bell Houses, Ltd. v. *City Wall Properties, Ltd*. (1966) 2 All E.R.674

14. Re Introductions, Ltd., Introductions, Ltd. v. National Provincial Bank Ltd. (1969) 1 All ER 887

Reference/Suggested Cases

- *Dr. A. Lakshmanaswami Mudaliar* v. *Life Insurance Corporation of India,* AIR 1963 SC 1185
- Shuttleworth v Cox Brothers and Company (Maidenhead), Limited, and Others, [1927] 2 K.B. 9
- Rayfield v Hands and Others, [1957 R. No. 603.]
- Jehangir Rastamji Modi V. Shamji Ladha (1867)BHCR185

(c) ***Doctrine of Indoor Management***; Binding Nature of Articles of Association between members/shareholders *inter se* and also outsiders; Rule of Constructive Notice; Doctrine of Indoor Management and its exceptions.

15. Royal British Bank v. *Turquand* (1856) 119 ER 886: (1843-60) All ER Rep. 435

16. Freeman & Lockyer (A Firm) v. *Buckhurst Park Properties (Mangal) Ltd*. (1964) 1 All ER 630

17. Kotla Venkataswamy v. C*hinta Ramamurthy,* AIR 1934 Mad. 579

18. Dehradun-Mussoorie Electric Tramway Co. v. Jagmandar Das and Others, AIR 1932 All 141.

Topic 4 : Capital Market Instruments

(a) Prospectus

Prospectus Sec. 2(70), Kinds- Abridged Sec.2 (1), Deemed Sec.25, Shelf Sec. 31, Red-Herring Sec. 32, Information Memorandum, Registration Sec.26, Remedies against Misrepresentation, Liabilities- Civil and Criminal.

(b) Company's Share Capital/Debenture

(a) *Equity Finance:* Shares Sec. 2(84), Kinds of Share capital Sec.43

(a) Equity share (b) Preference share

(b) *Debt Finance:* Debentures Sec. 2(30) Nature of shares or debentures Sec.44

Comparison between Share and Debenture

Topic 5 : Board of Directors

Corporate Governance; Appointment of Directors; Duties of Directors and their Criminal and Civil liabilities.

Director's Identification Number Sec.153-159

Independent Director Sec.2 (47)

Case Study on Satyam Scandal

19. *Percival* v. *Wright* (1902) 2 Ch. 421
20. *Burland* v. *Earle* (1902) AC 83: (1900-03) All ER Rep. 1452
21. *City Equitable Fire Insurance Co., Re* (1925) Ch. 407
22. *Regal (Hastings) Ltd*. v. *Gulliver* (1967) 2 A.C. 134 (HL)
23. *Industrial Development Consultants Ltd*. v. *Cooley* (1972) 1 WLR 443

Reference/Suggested Cases

- *Standard Chartered Bank* v. *Pakistan National Shipping Cop.* (2003) 1 All ER 173 (HL)
- *Sanjay Dutt v. State of Haryana, Supreme Court of India Judgment dated: January 2, 2025 [Criminal Appeal No.11 of 2025 {SLP (Cri) No. 7464/2024}]*

Topic 6 : General Meetings

Types / Kinds of Meetings, Essential Conditions of a Valid Meeting, Procedure for Calling Company Meetings.

Topic 7: Prevention of Oppression and Mismanagement

Protection of Minority Shareholders; Powers of Tribunal and Central Government; Prevention of Oppression and Mismanagement Sec.241-244;

Class Action Suit (Sec.245)

Foss v. ***Harbottle*** Rule - Exceptions – acts *ultra vires*, fraud on minority, acts requiring special majority, wrongdoers in control, etc.

24. Foss v. *Harbottle* (1843) 2 Hare 461: (1843) 67 ER 189
25. Shanti Prasad Jain v. *Kalinga Tubes Ltd.,* AIR 1965 SC 1535
26. Rajahmundry Electric Supply Corporation Ltd. v. A. *Nageshwara Rao,* AIR 1956 SC 213
27. Bharat Insurance Co. Ltd. v. *Kanhaiya Lal,* AIR 1935 Lah. 792
28. M.S.D.C. Radharamanan v. *M.S.D. Chandrasekara Raqja* (2008) 6 SCC 750: AIR 2008 SC 1738
29. Tata Consultancy Services Ltd. v. Cyrus Investments Private Ltd., (2021) 9 SCC 449.

Reference/Suggested Cases

- *1.H.R. Harmer Ltd*., *Re* (1958) 3 All E.R. 689
- *2.Scottish Co-operative Wholesale Society, Ltd*. v. *Meyer* 1959 AC 324
- *3.Needle Industries (India) Ltd*. v. *Needle Industries Newey (India) Holdings Ltd*.,AIR 1981 SC 1298

Topic 8 : Winding up of Companies

Winding up by the Tribunal: Sec.270 – Winding up by the Tribunal Sec.271-303;

30. German Date Coffee Co., In Re (1882) 20 Ch. D. 169
31. Seth Mohan Lal v. *Grain Chambers Ltd.,* AIR 1968 SC 772

Reference/Suggested Cases

- *1.Aluminum Corporation of India Ltd.* v. *M/s. Lakshmi Rattan Cotton Mills Co. Ltd.,* AIR 1970 All. 452
- *2.Yenidje Tobacco Co. Ltd., Re* (1916) 2 Ch. D. 169
- *3.Devas Employees Mauritius Private Limited v. Union of India,* High Court of Karnataka, Writ petition no.6191 of 2021, decided on 28th April, 2021

Topic 9 : Adjudicatory Bodies

National Company Law Tribunal; National Company Law Appellate Tribunal – Constitution, Powers, Jurisdiction, Procedure, Judicial Review Sec. 407-434

32. Madras Bar Association V. Union of India & Anr. Writ Petition (C) No. 1072 OF 2013 Decision on 14th May, 2015.
33. Embassy Property Developments Pvt. Ltd. v. State of Karnataka and Ors. MANU/SC/1661/2019

Topic 10 : Contemporary Developments

(a) Corporate Social Responsibility and Corporate Criminal Liability

Introduction to CSR; Need for CSR; CSR Sec. 135 under Companies Act, 2013; Companies (Corporate Social Responsibility Policy) Rules 2014 (CSR Rules, as amended) and Schedule VII of Companies Act, 2013

(b) Compromises, Arrangements and Amalgamations

Overview of the provisions under Chapter XV of Companies Act, 2013

Section 230 - Power to compromise or make arrangements with creditors and members; Section 231 - Power to Tribunal to enforce compromise or arrangement; Section 232 - Merger and amalgamation of companies.

(c) Insolvency and Bankruptcy Code, 2016 (IBC)

Overview / evolution and importance of the law;

Key Concepts - Committee of Creditors (CoC); Insolvency Resolution Professionals (IRP); Adjudicating Authority; Corporate Insolvency Resolution Process (CIRP); Moratorium

(d) ESG (Environment, Social & Governance)

What is ESG? Its importance and application in modern business; ESG and sustainability.

NOTE: This module aims to provide a conceptual introduction/understanding of the key emerging concepts in company law and the recent developments in the subject.

Readings/Suggested cases

- Arun Kumar Jagatramka v. Jindal Steel And Power Ltd., AIR 2021 SC 136
- *Understanding the IBC*, A HANDBOOK available in https://www.ibbi.gov.in/uploads/whatsnew/e42fddce80e99d28b683a7e21c81110e.pdf
- Iain MacNeil1 · Irene-marié Esser, "From a Financial to an Entity Model of ESG", *European Business Organization Law Review available in* httpss://www.researchgate.net

IMPORTANT NOTE:

1. The topics and cases given above are not exhaustive. The teachers teaching the course shall be at liberty to add new topics/cases.

2. The students are required to study the legislations as amended up-to-date and consult the latest editions of books.

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NATURE OF COMPANY

CORPORATE PERSONALITY

Salomon v. *Salomon & Co., Ltd.*

(1897) AC 22 (HL)

The appellant, Aron Salomon, had for some thirty years prior to 1892 carried on business as a leather merchant and hide factor and wholesale and export boot manufacturer under the style of A. Salomon & Co. A limited company was formed in 1892 to carry on the business, the subscribers to the memorandum of association being the appellant, his wife and daughter, and his four sons. The nominal capital of the company was £40,000, divided into £1 shares; 20,007 shares were issued, of which the appellant held 20,001, the other signatories of the memorandum of association holding one share each. The appellant's business was sold to the company for £38,782, of which £16,000 was to be paid in cash or debentures, and at the first meeting of the directors, who consisted of the appellant and two of his sons, it was resolved to pay the appellant £6,000 in cash and £10,000 in debentures. These debentures were afterwards mortgaged by the appellant to one Edmund Broderip as a security for an advance of £5,000, but eventually they were cancelled, and £10,000 fresh debentures were issued to Edmund Broderip. In October, 1893, an order was made for the winding-up of the company, at which date the company was indebted to unsecured creditors other than Aron Salomon to the amount of £7,773. An action was brought by the liquidator of the company against the appellant, which was tried before VAUGHAN WILLIAMS, J., who declared that the company were entitled to be indemnified by the appellant to the amount of £7,733. This decision was affirmed by the Court of Appeal.

LORD HALSBURY, L.C. – The important question in this case - is whether the respondent company was a company at all-whether, in truth, that artificial creation of the legislature had been validly constituted in this instance; and, in order to determine that question, it is necessary to look at what the statute itself has determined in that respect. I have no right to add to the requirements of the statute, nor to take from the requirements thus enacted. The sole guide must be the statute itself.

That there were seven actual living persons who held shares in the company has not been doubted [Companies Act, 1948 s. 1, which provides for the formation of a company by seven persons]. As to the proportionate amounts held by each I will deal with them presently; but it is important to observe that this first condition of the statute is satisfied, and it follows as a consequence that it would not be competent to anyone, and certainly not to these persons themselves, to deny that they were shareholders. I must pause here to point out that the statute enacts nothing as to the extent or degree of interest/which may be held by each of the seven, or as to the proportion of interest or influence possessed by one or the majority of the shareholders over the others. One share is enough. Still less is it possible to contend that the motive of becoming shareholders, or of making them shareholders, is a field of inquiry which

the statute itself recognises as legitimate. If they are shareholders they are shareholders for all purposes, and, even if the statute was silent as to the recognition of trusts, I should be prepared to hold that if six of them were the *cestuis que trust* of the seventh, whatever might be their rights *inter se*, the statute would have made them shareholders to all intents and purposes with their respective rights and liabilities.

Dealing with them in their relation to the company, the only relation which I believe the law would sanction would be that they were corporators of the corporate body. I am simply here dealing with the provisions of the statute, and it seems to me to be essential to the artificial creation that the law should recognise only that artificial existence, quite apart from the motives or conduct of individual corporators. In saying this I do not at all mean to suggest that if it could be established that this provision of the statute to which I am adverting had not been complied with, you could not go behind the certificate of incorporation to show that a fraud had been committed upon the officer entrusted with the duty of giving the certificate, and that by some proceeding in the nature *scire facias* you could not prove the fact that the company had no legal existence. But, short of such proof, it seems to me impossible to dispute that once the company is legally incorporated it must be treated like any other independent person with rights and liabilities appropriate to itself, and that the motives of those who took part in the promotion of the company are absolutely irrelevant in discussing what those rights and liabilities are.

I will, for the sake of argument, assume the proposition that the Court of Appeal lays down, that the formation of the company was a mere scheme to enable Salomon to carry on business in the name of the company. I am wholly unable to follow the proposition that this was contrary to the true intent and meaning of the Companies Act. I can only find the true intent and meaning of the Act from the Act itself, and the Act appears to me to give a company a legal existence with, as I have said, rights and liabilities of its own, whatever may have been the ideas or schemes of those who brought it into existence. I observe that VAUGHAN WILLIAMS, J., held that the business was Salomon's business and no one else's, and that he chose to employ as agent a limited company, and he proceeded to argue that he was employing that limited company as agent, and that he was bound to indemnify that agent-the company. I confess it seems to me that that very learned judge becomes involved by this argument in a very singular contradiction. Either the limited company was a legal entity or it was not. If it was, the business belonged to it and not to Salomon; if it was not, there was no person and nothing to be an agent at all; and it is impossible to say at the same time that there is a company and there is not. LINDLEY, L.J., on the other hand, affirms that there were seven members of the company, but, he says, it is manifest that six of them were members simply in order to enable the seventh himself to carry on business with limited liability, so that the object of the whole arrangement was to do the very thing which the legislature intended not to be done.

It is obvious to inquire where is that intention of the legislature manifested in the statute? Even if we were at liberty to insert words to manifest that intention, I should have great difficulty in ascertaining what the exact intention thus imputed to the legislature is or was. In this particular case it is the members of one family that represent all the shares; but if the supposed intention is not limited to so narrow a proposition as this, that the seven members

must not be members of one family, to what extent may influence or authority or intentional purchase of a majority among the shareholders be carried so as to bring it within the supposed prohibition? It is, of course, easy to say that it was contrary to the intention of the legislature-a proposition which, by reason of its generality, it is difficult to bring to the test; but when one seeks to put as an affirmative proposition what the thing is which the legislature has prohibited, there is, as it appears to me, an insuperable difficulty in the way of those who seek to insert by construction such a prohibition into the statute.

As one mode of testing the proposition it would be pertinent to ask whether two or three, or, indeed, all seven, may constitute the whole of the shareholders. Whether they must be all independent of each other in the sense of each having an independent beneficial interest - and this is a question that cannot be answered by the reply that it is a matter of degree. If the legislature intended to prohibit something, you ought to know what that something is. All it has said is that one share is sufficient to constitute a shareholder, though the shares may be 100,000 in number. Where am I to get from the statute itself a limitation of that provision that that shareholder must be an independent and beneficially interested person? I find all through the judgment of the Court of Appeal a repetition of the same proposition to which I have already adverted - that the business was the business of Aron Salomon, and that the company is variously described as a myth and a fiction.

LORD WATSON –The appellant, Aron Salomon, for many years carried on business, on his own account, as a leather merchant and wholesale boot manufacturer. With the design of transferring his business to a joint-stock company, which was to consist exclusively of himself and members of his own family, he, on July 20, 1892, entered into a preliminary agreement with one Adolph Anholt, as trustee for the future company, settling the terms upon which the transfer was to be made by him, one of its conditions being that, in part payment, he was to receive £10,000 in debentures of the company. A memorandum of association was then executed by the appellant, his wife, a daughter, and four sons, each of them subscribing for one share, in which the leading object for which the company was formed was stated to be the adoption and carrying into effect, with such modifications (if any) as might be agreed on, of the provisional agreement of July 20. The memorandum was registered on July 28, 1892, and the effect of registration, if otherwise valid, was to incorporate the company, under the name of "*Aron Salomon & Co.,Ltd*.", with liability limited by shares, and having a nominal capital of £ 40,000 divided into 40,000 shares of £1 each.

The company adopted the agreement of July 20, subject to certain modifications which are not material; and an agreement to that effect was executed between them and the appellant on Aug. 2, 1982. Within a month or two after that date the whole stipulations of the agreement were fulfilled by both parties. In terms thereof, 100 debentures, for £100 each, were issued to the appellant, who, upon the security of theses documents, obtained an advance of £5,000 from Edmund Broderip. In February, 1893, the original debentures were returned to the company and cancelled, and in lieu thereof, with the consent of the appellant as beneficial owner, fresh debentures to the same amount were issued to Mr. Broderip, in order to secure the repayment of his loan, with interest at 8 per cent. In September, 1892, the appellant applied for and obtained an allotment of 20,000 shares; and from that date until an

order was made for its compulsory liquidation, the share register of the company remained unaltered, 20,001 shares being held by the appellant and six shares by his wife and family. It was all along the intention of these persons to retain the business in their own hands, and not to permit any outsider to acquire an interest in it.

Default having been made in the payment of interest upon his debentures, Mr. Broderip, in September, 1893, instituted an action in order to enforce his security against the assets of the company. Thereafter a liquidation order was made and a liquidator appointed, at the instance of unsecured creditors of the company. It has now been ascertained that, if the amount realised from the assets of the company were, in the first place, applied in extinction of Mr. Broderip's debt and interest, there would remain a balance of about £1,055, which is claimed by the applicant as beneficial owner of the debentures. In the event of his claim being sustained there will be no funds left for payment of the unsecured creditors, whose debts amount to £ 7,333 8s. 6d. The liquidator lodged a defence in the name of the company, to the debenture suit, in which he counterclaimed against the appellant (i) to have the agreements of July 20 and Aug. 2, 1892, rescinded, (ii) to have the debentures already mentioned delivered up and cancelled, (iii) repayment of all sums paid by the company to the appellant under these agreements, and (iv) a lien for these sums upon the business and assets. The averments made in support of these claims were to the effect that the price paid by the company exceeded the real value of the business and assets by upwards of £8,200; that the arrangements made by the appellant for the formation of the company were a fraud upon the creditors of the company; that no board of directors of the company was ever appointed, and that in any case such board consisted entirely of the appellant, and there never was an independent board.

The case went to proof before VAUGAN WILLIAMS, J., when the liquidator was examined as a witness on behalf of the company, while evidence was given for the appellant by himself and by his son, Emanuel Salomon, one of the members of the company, who had been employed in the business for nearly twenty years. The evidence shows that before its transfer to the new company the business had been prosperous, and had yielded to the appellant annual profits sufficient to maintain himself and family and to add to his capital. It also shows that, at the date of the transfer, the business was perfectly solvent. The liquidator, whose testimony was chiefly directed toward proving that the price paid by the company was excessive, admitted in cross-examination that the business when transferred to the company was in a sound condition, and that there was a substantial surplus. No evidence was led tending to support the allegation that no board of directors was ever appointed, or that the board consisted entirely of the appellant. The non-success and ultimate insolvency of the business, after it came into the hands of the company, was attributed by the witness Emanuel Salomon to a succession of strikes in the boot trade, and there is not a tittle of evidence tending to modify or contradict his statement. I think it also appears from the evidence that all the members of the company were fully cognisant of the terms of the agreements of July 20 and Aug. 2, 1892, and that they were willing to accept and did accept those terms. The case was heard before the learned judge who, at the close of the argument, announced that he was not prepared to grant the relief craved by the company. He at the same time suggested that a

different remedy might be open to the company, and, on the motion of their counsel, he allowed the counterclaim to be amended.

In conformity with the suggestion thus made by the Bench, a new and alternative claim was added for (i) a declaration that the appellant is liable to indemnify the company against the whole of their unsecured debts, (ii) judgment against him for £ 7,733 8s. 3d., being the amount of these debts, and (iii) a lien for that amount upon all sums which might be payable to the appellant by the company, in respect of his debentures or otherwise, until the judgment was satisfied. There were also added averments to the effect that the company was formed by the appellant and that the debentures for £ 10,000 were issued in order that he might carry on the business and take all the profits without risk to himself, and also that the company was the "mere nominee and agent" of the appellant. The allegations of the company, in so far as they have any relation to the amended claim, their pith consisting in the averments made on amendment, were meant to convey a charge of fraud.

On re-hearing the case VAUGHAN WILLIAMS, J., without disposing of the original claim, gave the company decree of indemnity in terms of their amended claim. I do not profess my ability to follow accurately the whole chain of reasoning by which the learned judge arrived at that conclusion, but he appears to have proceeded mainly upon the ground that the appellant was in truth the company, the other members being either his trustees or mere "dummies", and, consequently, that the appellant carried on what was truly his own business under cover of the name of the company, which was nothing more than an alias for Aron Salomon. On appeal from his decision the Court of Appeal made an order finding it unnecessary to deal with the original claim, and dismissing the appeal in so far as it related to the amended claim. The ratio upon which that affirmance proceeded, as embodied in the order, was: "This court, being of opinion that the formation of the company, the agreement of August, 1892, and the issue of debentures to Aron Salomon pursuant to such agreement, were a mere scheme to enable him to carry on business in the name of the company, with limited liability, contrary to the intent and meaning of the Companies Act, 1862, and, further, to enable him to obtain a preference over other creditors of the company by procuring a first charge on the assets of the company by means of such debentures..."

The opinion delivered by the lords justices are strictly in keeping with the reasons assigned in their order. LINDLEY, L.J., after observing "that the incorporation of the company cannot be disputed", refers to the scheme of the formation of the company, and says, "the object of the whole arrangement is to do the very thing which the legislature intended not to be done", and he adds that "Mr. Salomon's scheme is a device to defraud creditors." Assuming that the company was well incorporated in terms of the Act of 1862, an assumption upon which the decisions appealed from appear to me to throw considerable doubt, I think it expedient before considering the amended claim, to deal with the original claim for rescission, which was strongly pressed upon us by counsel for the company, under their cross-appeal. Upon that branch of the case there does not appear to me to be much room for doubt. With the exception that the word "exorbitant" appears to me to be too strong an epithet I entirely agree with VAUGHAN WILLIAMS, J., when he says:

> "I do not think that when you have a private company, and all the shareholders in the company are perfectly cognisant of the conditions under which the company is

formed, and the conditions of the purchase by the company, you can possibly say that purchasing at an exorbitant price (and I have no doubt whatever that the purchase here was at an exorbitant price) is a fraud upon those shareholders or upon the company."

The learned judge goes on to say that the circumstances might have amounted to fraud if there had been an intention on the part of the original shareholders "to allot further shares at a later period to future allottees." Upon that point I do not find it necessary to express any opinion, because it is not raised by the facts of the case, in my view, these considerations are of no relevancy in a question as to rescission between the company and the appellant.

Counsel for the company argued that the agreement of Aug. 2 ought to be set aside, upon the principle followed by this House in ***Erlanger* v. *New Sombrero Phosphate Co***. [(1874-80) All ER Rep. 271]. In that case the vendor, who got up the company, with the view of selling his adventure to it, attracted shareholders by a prospectus which was essentially false. The directors, who were virtually his nominees, purchased from him without being aware of the real facts; and on their assurance that, in so far as they knew, all was right the shareholders sanctioned the transaction. The fraud by which the company and its shareholders had been misled was directly traceable to the vendor; and the transaction was set aside at the instance of the liquidator, the Lord Chancellor (EARL CAIRNS) expressing a doubt whether, even in those circumstances, the remedy was not too late, after a liquidation order. But in the present case the agreement of July 20 was, in the full knowledge of the facts, approved and adopted by the company itself, if there was a company, and by all the shareholders who ever were or were likely to be members of the company. In my opinion, therefore, ***Erlanger* v. *New Sombrero Phosphate Co.*** has no application, and the original claim of the liquidator is not maintainable.

* * * * *

Bennett Coleman & Co. & Ors v. Union Of India & Ors
(1972) 2 SCC 788: AIR 1973 SC 106.

The majority judgment of Sikri, C.J. and Ray and Jaganmohan Reddy, JJ. was delivered by Ray, J. Beg, J. delivered a separate concurring opinion. Mathew, J. delivered a separate dissenting opinion.

A.N. RAY, J. These petitions challenge the Import Policy for Newsprint for the year April 1972 to March 1973. The Newsprint Policy is impeached as an infringement of fundamental rights to freedom of speech and expression in Article 19(1)(a) and right to equality in Article 14 of the Constitution. Some provisions of the Newsprint Control Order 1962 are challenged as violative of Article 19(1)(a) and Article 14 of the Constitution.

2. The import of newsprint is dealt with by Import Control Order, 1955 (referred to as the 1955 Import Order). The 1955 Import Order is made in exercise of powers conferred by sections 3 and 4-A of the Imports and Exports Control Act, 1947 (referred to as the 1947 Act). Section 3 of the 1947 Act, speaks of powers of the Central Government to prohibit, restrict or otherwise control imports and exports. Section 4-A of the 1947 Act contemplates issue or renewal of licences under the 1947 Act for imports and exports. Item 44 in Part V of Schedule I of the 1955 Import Order relates to newsprint. Newsprint is described as white printing paper (including water lined newsprint which contained mechanical wood pulp amounting to not less than 70% of the fibre content). The import of newsprint is restricted under the 1955 Import Order. This restriction of newsprint import is also challenged because it infringes Article 19(1)(a). It is said that the restriction of import is not a reasonable restriction within the ambit of Article 19(2).

3. The Newsprint Control Order 1962 (referred to as the "1962 Newsprint Order") is made in exercise of powers conferred by section of the Essential Commodities Act 1955 (referred to as "the 1955 Act"). Section 3 of the 1955 Act enacts that if the Central Government is of opinion that it is necessary or expedient so to do for maintaining or increasing supply of essential commodities or for securing their equitable distribution and availability at fair prices, it may, by order, provide for regulating or prohibiting production, supply and distribution and trade and commerce therein. Section 2 of the 1955 Act defines "essential commodity" Paper including newsprint, paper board and straw board is defined in section 2 (a) (vii) of the 1955 Act to be an essential commodity.

4. The 1962 Newsprint Order in clause 3 mentions restrictions on acquisition, sale and consumption of newsprint. Sub- clause 3 of clause 3 of the 1962 Newsprint Order states that no consumer of newsprint shall, in any licensing period, consume or use newsprint in excess of the quantity authorised by the Controller from time to time. Sub-clause 3A of clause 3 of the 1962 Newsprint Order states that no consumer of newsprint, other than a publisher of text books or books of general interest, shall use any kind of paper other than newsprint except with the permission, in writing, of the Controller. Sub-clause 5 of clause 3 of the 1962

Newsprint Order states that in issuing an authorisation under this clause, the Controller shall have regard to the principles laid down in the Import Control Policy with respect of newsprint announced by the Central Government from, time to time. Sub-clauses 3 and 3A of clause 3 of the 1962 Newsprint Order are challenged in these petitions on the ground that these clauses affect the volume of circulation, the size and growth of a newspaper and thereby directly infringe Article 19(1)(a) of the Constitution. The restrictions mentioned in these sub-clauses of clause 3 of the 1962 Newsprint Order are also said to be not reasonable restrictions within the ambit of Article 19(2) of the Constitution.

5. Sub-clauses 3 and 3A of clause 3 of the 1962 Newsprint Order are further impeached on the ground that they offend Article 14 of the Constitution. Sub-clause 3A is said to confer unfettered and unregulated power and uncontrolled discretion to the Controller in the matter of granting of authorisation. It is said that there are no provisions for redress of grievances by way of appeal or revision of the Controller's decision in the matter of grant or renewal of authorisation. The restrictions are said to be not reason- able or justified in the interest of general public. The distinction between publishers of text-books and books of general interest on the one hand and other consumers of newsprint on the other in sub-clause 3A is said to be discriminatory and without any rational basis. Again, the disability imposed by sub-clause 3A on newspapers preventing them from using printing and writing paper while permitting all other consumers to do so, is said to be irrational discrimination between newspapers and periodicals as the latter are permitted to use unlimited quantity of printing and writing paper in addition to their allocation of newsprint.

6. The Newsprint Policy of 1972-73 referred to as the Newsprint Policy deals with white printing paper (including water lined newsprint which contained mechanical wood pulp amounting to not less than 70 per cent of the fibre content). Licences are issued for newsprint. The validity of licences is for 12 months. The Newsprint Policy defines "common ownership unit" to mean newspaper establishment or concern owning two or more news interest newspapers including at least one daily irrespective of the centre of publication and language of such newspapers. Four features of the Newsprint Policy are called in question. These restrictions imposed by the Newsprint Policy are said to infringe rights of freedom of speech and expression guaranteed in Article 19(1)(a) of the Constitution. First, no new paper or new edition can be started by a common ownership unit even within the authorised quota of newsprint. Secondly, there is a limitation on the maximum number of pages to 10. No adjustment is permitted between circulation and the pages so as to increase the pages. Thirdly, no inter-changeability is permitted between different papers of common ownership unit or different editions of the same paper. Fourthly, allowance of 20 per cent increase in page level up to a maximum of 10 has been given to newspapers, with less than 10 pages. It is said that the objectionable and irrational feature of the Newsprint Policy is that a big daily newspaper is prohibited and prevented from increasing the number of pages, page area and periodicity by reducing circulation to meet its requirement even within its admissible quota. In the Newsprint Policy for the year 1971-72 and the earlier periods the newspapers and periodicals were permitted to increase the number of pages, page area and periodicity by reducing circulation. The current policy prohibits the same. The restrictions are, therefore, said to be

irrational, arbitrary and unreasonable. Big daily newspapers having large circulation contend that this discrimination is bound to have adverse effects on the big daily newspapers.

7. The Newsprint Policy is said to be discriminatory and violative of Article 14 because common ownership units alone are prohibited from starting a new paper or a new edition of the same paper while other newspapers with only one daily are permitted to do so. The prohibition against inter- changeability between different papers of the same unit and different editions of the said paper is said to be arbitrary and irrational, because it treats all common ownership units as equal and ignores pertinent and material differences between some common ownership units as compared to others. The 10 page limit imposed by the policy is said to violate Article 14 because it equates newspapers which are unequal and provides the same permissible page limit for newspapers which are essentially local in their character and news- papers which reach larger sections of people by giving world news and covering larger fields. The 20 per cent increase allowed for newspapers, whose number of pages was less than 10 is also challenged as violative of Article 14 by discriminating against newspapers having more than 10 pages. The difference in entitlement between newspapers with an average of more than 10 pages as compared with newspapers of 10 or less than 10 pages is said to be discriminatory because the differentia is not based on rational incidence of classification.

8. The import policy for newsprint has a history. From 1963-64 quota of newsprint for dailies has been calculated on the basis of page level of 1957 and circulation of 1961-62 with ad hoc increases for growth on the basis of percentage of pages calculated on circulation and allowance of page increase of not more than 2 pages at a time subject to a maximum of 12 pages. The bulk of newsprint was imported in the past. Indigenous newsprint was limited in supply. From 1963-64 till 1970-71 printing and writing paper available in our country was taken into account for framing the import policy. The quantity which could be made available to consumers of newsprint for the requirements of publishers of text-books were considered in that behalf. After 1971-72 printing and writing paper was in short supply. According to the Government this was adversely affecting the requirements of the publishers of text-books. The loss to newsprint consumer from the non-availability of white printing paper was made good in additional quantity of imported newsprint. The import quota of newsprint was increased from 1,40,000 tonnes in 1970-71 to 1.80,000 tonnes in 1971-72.

9. From 1972-73 with regard to daily newspapers three principal changes were effected. First, the base year for circulation was taken at 1970-71. Second, the page level was taken at the maximum of 10 pages instead of the previously operating 10 page level. Those operating at a page level of over 10 pages were given the facility of basing their required quota either on actual circulation for 1970-71 or admissible or calculated circulation for 1971-72 whichever is more. Third, the increase in quota for growth was allowed as in the past, In the case of circulation growth it was stipulated in terms of percentage of circulation over the previous year. In the case of page growth the maximum of 10 pages was permitted.

10. The Additional Solicitor General raised two pleas in demurrer. First, it was said that the petitioners were companies and therefore. they could not invoke fundamental rights. Secondly, it was, said that Article 358 of the Constitution is a bar to any challenge by the petitioners of violation of fundamental rights.

11. This Court in *State Trading Corporation of India Ltd. v. The Commercial Tax Officer, Visakhapatnam*(1) and *Tata Engineering & Locomotive Co. v. State of Bihar* (2) expressed the view that a corporation was not a citizen within the meaning of Article 19, and, therefore, could not invoke that Article. The majority held that nationality and citizenship were distinct and separate concepts. The view of this Court was that the word "citizen" in Part II and in Article 19 of the Constitution meant the same thing. The result was that an incorporated company could not be a citizen so as to invoke fundamental rights. In the State Trading Corporation(1) case (supra) the Court was not invited to "tear the corporate veil". In the Tata Engineering & Locomotive Co. (2) case (supra) this Court said that a company was distinct and separate entity from shareholders. The corporate veil it was said could be lifted in cases where the company is charged with trading with the enemy or perpetrating fraud on the Revenue authorities. Mukherjea J., in *Chiranjit Lal Choudhuri v. The Union of India & Ors.* (3) expressed the minority view that an incorporated company can come up to this Court for enforcement of fundamental rights.

12. There are however decisions of this Court where relief has been granted to the petitioners claiming fundamental rights as shareholders or editors of newspaper companies. These are *Express Newspapers (Private) Ltd. & Anr. v. The Union of India & Ors.* (4) and *Sakal Papers (P) Ltd. & Ors. v. The Union of India* (5).

13. In *Express Newspapers* (4) *case* (supra) the Express News papers (Private Ltd. was the petitioner in a writ petition under Article 32. The Press Trust of India Limited was another petitioner in a similar writ petition. The Indian National Press (Bombay) Private Ltd. otherwise known as the "Free Press Group" was a petitioner in the third writ petition. The Saurashtra Trust was petitioner for a chain of newspapers in another writ petition. The Hindustan Times Limited was another petitioner. These petitions in the Express Newspapers(4) case (supra) challenged the vires of the Working Journalists (Conditions of Service) and Miscellaneous Provisions Act, 1955. The petitioners contended that the provisions of the Act violated Articles 19(1) (a), 19(1)(g) and 14 of the Constitution.

14. In Sakal Papers(5) case (supra) the petitioners were a Private limited company carrying on business of publishing daily and weekly newspapers in Marathi and two shareholders in the company. There were two other petitions by readers of "Sakar" newspaper. 'Me reader petitioners also challenged the constitutionality of the Act. The petitioners there challenged the Daily Newspapers (Price and Page) Order, 1960 as contravening Article 19(1)(a) of the Constitution.

(1) [1964] 4 S.C.R. 99. (2) [1964] 6 S.C.R. 885. (3) [1950]S.C.R. 869. (4) [1959] S.C.R. 12. (5) [1962] 3 S.C.R. 842.

15. Neither in the *Express Newspapers case* (supra) nor in *Sakal Papers case* (supra) there appears to be any plea raised about the maintainability of the writ petition on the ground that one of the petitioners happened to be a company.

16. In the *Express Newspapers case* (supra) this Court held that freedom of speech and expression includes within its scope the freedom of the Press. This Court referred to the earlier decisions in *Romesh Thappar v. State of Madras* (1) and *Brij Bhushan v. State of Delhi* (2). Romesh Thappar's case (supra) related to a ban on the entry and circulation of Thapper's journal in the State of Madras under the provisions of the Madras Maintenance of Public Order Act, 1949. Patanjali Sastri, J. speaking for the Court said in *Romesh Thappar's case* (supra) that "there can be no doubt that the freedom of speech and expression includes freedom of propagation of ideas and that freedom is ensured by the freedom of circulation. Liberty of circulation is as essential to that freedom as the liberty of publication. Indeed, without circulation publication would be of little value". In *Brij Bhushan's case* (supra) Patanjali Sastri, J. speaking for the majority judgment again said that every free man has undoubted right to lay what sentiments he pleases before the public; to forbid this, is to destroy the freedom of the press". Bhagwati, J. in the *Express Newspapers case* (supra) speaking for the Court said that the freedom of speech and expression includes freedom of propagation of ideas which freedom is ensured by the freedom of circulation and that the liberty of the press is an essential part of the right to freedom of speech and expression and that the liberty of the press consists in allowing no previous restraint upon publication.

17. Describing the impugned Act in the *Express Newspapers case* (supra) as a measure which could be legitimately characterised to affect the press this Court said that if the intention or the Proximate effect and operation of the Act was such as to bring it within the mischief of Article 19(1)(a) it would certainly be liable to be struck down. But the Court found in the *Express Newspapers case* (supra) that the impugned, measures were enacted for the benefit of the working journalists and it was, therefore, neither the intention nor the effect and operation of the impugned Act to take away or abridge the right of freedom of speech and expression enjoyed by the petitioners. There are ample observations of this Court in the *Express Newspapers case* (supra) to support the right of the petitioner companies there to invoke fundamental right in aid of freedom of speech and expression enshrined in the freedom of the press. This Court said that if the impugned measure in that case fell within the vice of Article 19(1)(a) it would be struck down. This observation is an illustration of the manner in which the truth and spirit of the freedom of press is preserved and protected.

(1) [1950] S.C.R. 594 (2) [1950] S.C.R. 605

18. *In Sakal Papers case* (supra) this Court struck down section 3(1) of the Newspaper (Price and Page) Act, 1956 and allowed the petitioner company relief-on that basis. In the, Sakal

Papers case (supra) relief was granted to the shareholders and the company. The Court thought it unnecessary to express any opinion on the right of the readers to complain of infraction of fundamental rights in Article 19(1)(a) by reason of impact of law abridging or taking way the freedom of speech and expression.

19. In the present case, the petitioners in each case are in addition to the company the shareholders, the, editors and the publishers. In the Bennett Coleman group of cases one shareholder, a reader of the publication and three editors of the three dailies published by the Bennett Coleman Group are the petitioners. In the *Hindustan Times case* a shareholder who happened to be a Deputy Director, a shareholder, a Deputy Editor of one of the publications, the printer and the publisher of the publications and a reader are the petitioners. In the *Express Newspapers case* the company and the Chief Editor of the dailies are the petitioners. In the *Hindu case* a shareholder, the Managing Editor, the publisher of the company are the petitioners. One of the important questions in these petitions is whether the shareholder, the editor, the printer, the Deputy Director who are all citizens and have the right to freedom under Article 19(1) can invoke those rights for freedom of speech and expression, claimed by them for freedom of the press in their daily publication. The petitioners contend that as a result of the Newsprint Control Policy of 1972-73 their freedom of speech and expression exercised through their editorial staff and through the medium of publications is infringed. The petitioners also challenge the fixation of 10 page ceiling and the restriction on circulation and growth on their publications to be not only violative of but also to abridge and take away the freedom of speech and expression of the shareholders and the editors. The shareholders, individually and in association with one, another represent the medium of newspapers through which they disseminate and circulate their views and news. The newsprint policy express them to heavy financial loss and impairs their right to carry on the business of printing and publishing of the dailies through the medium of the companies.

20. In *R. C. Cooper v. Union of India* (1) which is referred to as the *Bank Nationalisation*(1) *case* Shah, J. speaking for the majority dealt with the contention raised about the maintainability of the petition. The petitioner there was a shareholder, a Director and holder of deposit of current accounts in the Bank. The locus standi of the petitioner was challenged on the ground that no fundamental right of the petitioner there was directly impaired by the enactment of the Ordinance and the Act or any action taken thereunder. The petitioner in the *Bank Nationalisation case* (supra) claimed that the rights guaranteed to him under Articles 14, 19 and 31 of the Constitution were impaired. The petitioner's grievances were these. The Act and the Ordinance were without legislative competence. The Act and the Ordinance interfered with the guarantee of freedom of trade. They were not made in public interest. The President had no power to promulgate the Ordinance. In consequence of hostile discrimination practiced by the State the value of the petitioner's investment in the shares is reduced. His right to receive dividends ceased. He suffered financial loss. He was deprived of the right as a shareholder to carry on business through the agency of the company.

21. The ruling of this Court in *Bank Nationalisation case* (supra) was this :

"A measure executive or legislative may impair the rights of the company alone, and not of its shareholders; it may impair the rights of the shareholders not of the Company; it may impair the rights of the shareholders as well as of the company. Jurisdiction of the Court to grant relief cannot be denied, when by State action the rights of the individual shareholder are impaired, if- that action, impairs the rights of the Company as well. The test in determining whether the shareholder's right is impaired is not formal; it is essentially qualitative; if the State action impairs the right of the shareholders- as well as of the Company, the Court will not, concentrating merely upon the technical operation of the action, deny itself jurisdiction to grant relief."

(1) [1970] 3 S.C.R. 530.

22. In the *Bank Nationalisation case* (supra) this Court held the statute to be void for infringing the rights under Articles 19(1)(f) and 19(1)(g) of the Constitution. In the *Bank Nationalisation case* (supra) the petitioner was a shareholder and a director of the company which was acquired under the statute. As a result of the *Bank Nationalisation case* (supra) it follows that the Court finds out whether the legislative measure directly touches the company of which the petitioner is a shareholder. A shareholder is entitled to protection of Article 19. That individual right is not lost by reason of the fact that he is a shareholder of the company. The *Bank Nationalisation case* (supra) has established the view that the fundamental rights of shareholders as citizens are not lost when they associate to from a company. When their fundamental rights as shareholders are impaired by State action their rights as shareholders are protected. The reason is that the shareholders' rights are equally and necessarily affected if the rights of the company are affected. The rights of shareholders with regard to Article 19(1)(a) are projected and manifested by the newspapers owned and controlled by the shareholders through-the medium of the corporation. In the present case, the individual rights of freedom of speech and expression of editors, Directors and shareholders are all exercised through their newspapers through which they speak. The press reaches the public through the Newspapers. The shareholders speak through their editors- The fact that the companies are the petitioners does not prevent this Court from giving relief to the shareholders, editors, printers who have asked for protection of their fundamental rights by reason of the effect of the law and of the action upon their rights. The locus standi of the shareholder petitioners is beyond challenge after the ruling of this Court in the *Bank Nationalisation case* (supra). The presence of the company is on the same ruling not a bar to the grant of relief.

23. The rulings in *Sakal Papers case* (supra) and *Express Newspapers case* (supra) also support the competence of the petitioners to maintain the proceedings.

34. Publication means dissemination and circulation. The press has to carry on its activity by keeping in view the class of readers, the conditions of labour, price of material, availability of advertisements, size of paper and the different kinds of news comments and' views and advertisements which are to be published and circulated. The law which lays excessive and prohibitive burden which, would restrict the circulation of a newspaper will not be saved by

Article 19(2). If the area of advertisement is restricted, price of paper goes up. If the price goes up circulation will go down. This was held in *Sakal Papers case* (supra) to be the direct consequence of curtailment of advertisement. The freedom of a newspaper for publish any number of pages or to circulate it to any number of persons has been held by this Court to be an integral part of the freedom of speech and expression. This freedom is violated by placing restraints upon it or by placing restraints upon something which is an essential part of that freedom. A restraint on the number of pages, a restraint on circulation and a restraint on advertisements would affect the fundamental rights under Article 19(1)(a) on the aspects of propagation, publication and circulation.

40. The question neatly raised by the petitioners was whether the impugned Newsprint Policy is in substance a newspaper control. A newspaper control policy is ultra vires the Import Control Act and the Import Control Order. Entry 19 of List 1 of the 1935 Act could empower Parliament to control imports. Both the State legislature and Parliament have power to legislate upon newspapers falling under Entry 17 of List III. The two fields of legislation are different. The Import Control Act may include control of import of newsprint but it does not allow control of newspapers. The machinery of the Import Control cannot be utilised to curb or control circulation of growth or freedom of newspapers in India. The pith and substance doctrine is used in ascertaining whether the Act falls under one Entry while incidentally encroaching upon another Entry. Such a question does not arise here. The Newsprint Control Policy is found to be newspaper control order in the guise of framing an Import Control Policy for newsprint.

41. This Court in the *Bank Nationalisation case* (supra) laid down two tests. First it is not the object of the authority making the law impairing the right of the citizen nor the form of action that determines the invasion of the right. Secondly, it is the effect of the law and the action upon the right which attracts the jurisdiction of the court to grant relief. The direct operation of the Act upon the rights forms the real test.

42. In *Sakal Papers case* (supra) this Court referred to the ruling in *Dwarkadas Shrinivas v. The Sholapur & Weaving Co. Ltd.* (1) that it is the substance and the practical result of the act of the State that should be considered rather than the pure legal form. The correct approach _should be to enquire what in substance is the loss or injury caused to the citizen and not merely what manner and method has been adopted by the State in placing the, restrictions in *Sakal Papers case* (supra) raising the price affected and infringed fundamental rights. In *Sakal Papers case* (supra) this Court said that the freedom of a newspaper to publish any number of pages or to circulate it to any number of persons is each an integral part of the freedom of speech and expression. A restraint placed upon either of them would be a direct infringement of the right of freedom of speech and expression. The impact on the freedom of the press would still be direct in spite of the fact that it is not said so with words. No law or action would state in words that rights of freedom of speech and expression are abridged or taken away. That is why Courts have to protect and guard fundamental rights by considering the scope and provisions of the Act and its effect upon the fundamental rights. The ruling of this Court in Bank Nationalisation case (supra) is the test of direct operation upon the rights. By

direct operation is meant the direct consequence or effect of the Act upon the rights. The decision of the Privy Council in Commonwealth of Australia v. Bank of New South Wales (2) also referred to the test, as to whether/the Act directly restricted inter-State business of banking, in order to ascertain whether the Banking Act 1947 in that case is aimed or directed at, and the purpose, object and intention of the Act is restriction of inter-State trade, commerce and inter-course.

(1) [1954] S.C.R. 674. (2) [1950] A.C. 235.

43. The various provisions of the newsprint import policy have been examined to indicate as to how the petitioners' fundamental rights have been infringed by the restrictions on page limit, prohibition against new newspapers and new editions. The effect and consequence of the impugned policy upon the newspapers is directly controlling the growth and circulation of newspapers. The direct effect is the restriction upon circulation of newspapers. The direct effect is upon growth of newspapers through pages. The direct effect is that newspapers are deprived of their area of advertisement. The direct effect is that they are exposed to financial loss. The direct effect is that freedom of speech and expression is infringed.

45. It is indisputable that by freedom of the press is meant the right of all citizens to speak, publish and express their views. The freedom of the press embodies the right of the people to read. The freedom of the press is not antithetical to the right of the people to speak and express.

46. Article 13 of our Constitution states that the State is prohibited from making any law which abridges or takes away any fundamental rights. Again, Article 19(2) speaks of reasonable restrictions on the exercise of fundamental rights to freedom of speech and expression. Our Constitution does not speak of laws regulating fundamental rights. But there is no bar on legislating on the subject of newspapers as long as legislation does not impose unreasonable restrictions within the meaning of Article 19(2) . It is also important to notice as was done in earlier decisions of this Court that our Article 19(1)(a) and the First Amendment of the American Constitution are different. The First Amendment of the American Constitution enacts that the Congress shall make no law... abridging the freedom of speech or of the press. The American First Amendment contains no exceptions like our Article 19(2) of the Constitution. Therefore, American decisions have evolved their own, exceptions. Our Article 19(2) speaks of reasonable restrictions. Our Article 13 states that the State shall not make laws which abridge or take away fundamental rights in Part III of the Constitution.

62. There are only 7 dailies of above 12 pages until the impugned policy hit these. Those are Amrita Bazar Patrika, Bombay Samachar. Hindu, Hindustan Times, Indian Express (Delhi, Bombay, Madurai, Vijayawada and Bangalore editions), the Times of India (Bombay and Delhi editions) and the Statesman. Out of these 7 dailies 6 are English dailies. Bombay Samachar is a Gujarati daily. The maximum page level fixed at 10 and the prohibition against the adjustability between pages and circulation are strongly impeached by the petitioners.

These 7 dailies except Bombay Samachar are common ownership units. Some of them publish other leading language dailies also. The maximum number of pages at 10 will, according to the petitioners, not only adversely affect their profits but also deprive them of expressing and publishing the quality of writings and fulfilment of the role to be played by the newspaper in regard to their freedom of speech and expression. While it must be admitted that the language dailies should be allowed to grow, the English dailies should not be forced to languish under a policy of regimentation. It is therefore correct that the compulsory reduction to 10 pages offends Article 19(1)(a) and infringes the rights of freedom of speech and expression.

69. The justification pleaded by the Government is that big dailies chose to increase pages rather than circulation in the past. In the past the newsprint allocation was based on the page level of 1957 and the circulation figures of 1961-62. The Government says that newspapers which started after 1961-62 were unable to increase their pages. Therefore, the present policy is intended to remove that position. In our judgment it will depend on each paper as to how it will grow. Those who are growing should not be restricted if they can grow within their quota. In the past dailies having less than 10 pages were given increases and were allowed to come up to 10 pages from 4 pages in 1961-62 and 6 pages in 1962-63. Most of them could not even fully utilize the page increase allowed. The present impeached policy seeks to remove iniquities created by previous policies. It depends upon facts as to how much more newsprint a group of newspapers started after 1961-62 will require and secondly whether they are in a position to increase the page number. It also appears that 19 language dailies reduced their page numbers on the basis of which the quota was calculated in order to increase their circulation. Therefore, there appears to be no justification for giving them additional quota for increasing page numbers by reducing the quota of the big dailies by imposing upon them the 10 page ceiling. The 10 page ceiling imposed affecting 22 big newspapers operating above 10 page level with approximate circulation of over 23 lakhs i.e. more than 25% of the total circulation is arbitrary and treats them equally with others who, are unequal irrespective of the needs and requirements of the big dailies and thus violates Article 14 of the Constitution.

70. The impeached policy violates Article 14 because it treats newspapers which are not equal equally in assessing the needs and requirements of newsprint. The Government case is that out of 35 newspapers which were operating on a quota calculated on a higher page level than 10 pages 28 newspapers will benefit by the impeached policy of 1972-73. But 7 newspapers out of 22 which were operating above 10 page level are placed at a disadvantage by the fixation of 10 page limit and entitlement to quota on that basis. There is no intelligible differentia. Nor has this distinction any relation to equitable distribution of newsprint. The impeached policy also offends Article 19(1)(a) of the Constitution. Newspapers like 19 language dailies reduced their pages in order to increase circulation though such language dailies had prior to 1972-73 been given quota to increase pages. Under the impeached policy these language dailies are given additional quota to increase their pages against to 10.

71. The basic entitlement in Remark V to quota for newspapers operating above 10 page level violates Article 19(1)(a) because the quota is hedged in by direction not to increase the page

number above 10. The reduction of page limit to 10 for the aforesaid reasons violates Article 19(1)(a) and Article 14 of the Constitution.

72. The other features in the newsprint policy complained of are those in Remark VII (c) read with Remark VIII of the impeached policy. Remark VII (c) allows 20 per cent increase to daily newspapers in the number of pages within the ceiling of 10 over the average number of pages on which the basic entitlement is fixed under Remark V. In other words, dailies with less than 10 pages are prevented from adjusting the quota for 20 per cent increase for increase in circulation. The Bennett Coleman group says that their *Nav Bharat Times, Maharashtra Times* and *Economic Times* would prefer to increase their circulation. Under Remark V they are entitled to quota on the basis of consumption in 1970-71 or 1971-72 whichever is less. This feature also indicates that the newsprint policy is not based on circulation. Under Remark VII (c) these newspapers within the ceiling of 10 can get 20 per cent increase in the number of pages. They require circulation more than the number of pages. They are denied circulation as a result of this policy. The big English dailies which need to increase their pages are not permitted to do so. Other dailies which do not need increase in pages are permitted quota for increase but they are denied the right of circulation. In, our view, these features were rightly said by counsel for the petitioners to be not newsprint control but newspaper control in the guise of equitable distribution of newsprint. The object of the impeached policy is on the one hand said to increase circulation and on the other to provide for growth in pages for others. Freedom of speech and expression is not only in the volume of circulation but also in the volume of news and views.

75. The restriction on the petitioners that they can use their quota, to increase circulation but not the page number violates Articles 19 (1) (a) as also Article 14. Big dailies are treated to be equal with newspapers who are not equal to them. Again, the policy of 1972-73 permits dailies with large circulation to increase their circulation. Dailies operating below 10 page level are allowed increase in pages. This page increase quota cannot be used for- circulation increase. Previously, the big dailies were allowed quota for circulation growth. The present policy has decreased the quantity for circulation growth. In our view counsel for the petitioners rightly said that the Government could not determine thus which newspapers should grow in page and circulation and which newspapers should grow only in circulation and not in pages. Freedom of press entitles newspapers to achieve any volume of circulation. Though requirements of newspapers as to page, circulation are both taken into consideration for fixing their quota but the newspapers should be thereafter left free to adjust their page number and circulation as they wish in accordance with the dictates of Article 19(1)(a) of the Constitution.

80. The faith of a citizen is that political wisdom and virtue will sustain themselves in the free market of ideas so long as the channels of communication are left open. The faith in the popular Government rests on the old dictum "let the people have the truth and the freedom to discuss it and all will go well". The liberty of the press remains an "Art" of the Covenant" in every democracy. Steel will yield products of steel. Newsprint will manifest whatever is thought of by man. The newspapers give ideas. The newspapers give the people the freedom

to find out what ideas are correct. Therefore, the freedom of the press is to be enriched by removing the restrictions on page limit and allowing them to have new editions or new papers. It need not be stressed that if the quantity of newsprint available does not permit grant of additional quota for new papers that is a different matter. The restrictions are to be removed. Newspapers have to be left free, to determine their pages, their circulation and their new editions within their quota of what has been fixed fairly.

82. In the present case, it cannot be said that the newsprint policy is a reasonable restriction within the ambit of Article 19(2). The newsprint policy abridges the fundamental rights of the petitioners in regard to freedom of speech and expression. The newspapers are not allowed their right of circulation- The newspapers are not allowed right of page growth. The common ownership units of newspapers cannot bring out newspapers or new editions. The newspapers operating above 10 page level and newspapers Operating below 10 page level have been treated equally for assessing the needs and requirements of newspapers with newspapers which are not their equal, Once the quota is fixed and direction to use the quota in accordance with the newsprint policy is made applicable the big newspapers are prevented any increase in page number. Both page numbers and circulation are relevant for calculating the basic quota and allowance for increases. In the garb of distribution of newsprint the Government has tended to control the growth and circulation of newspapers. Freedom of the press is both qualitative and quantitative. Freedom lies both in circulation and in content. The newsprint policy which permits newspapers to increase circulation by reducing the number of pages, page area and periodicity, prohibits them to increase the number of pages, page area and periodicity by reducing circulation. These restrictions constrict the newspapers in adjusting their page number and circulation.

88. For the foregoing reasons the newsprint policy for 1972-73 violates Articles 19 (1) (a) and 14 of the Constitution. The restrictions by fixing 10 page limit in Remarks V and VIII of the policy infringe Articles 19 (1)(a) and 14 of the Constitution and are therefore, declared unconstitutional and struck down. The policy of basic entitlement to quota in Remark V is violative of Articles 19(1)(a) and 14 of the Constitution and is therefore struck down. The measure in Remark VII(a) is violative of Articles 14 and 19 (1) (a) of the Constitution and is struck down.

89. The measures in Remark VII(c) read with Remark VIII are violative of Articles 19(1)(a) and 14 of the Constitution and are struck down. The prohibition in Remark X against common ownership unit from starting a new newspaper/periodical or a new edition is declared unconstitutional and struck down as violative of Article 19(1)(a) of the Constitution.

90. For these reasons the petitioners succeed. The import policy for newsprint for the year 1972-73 in regard to Remarks V, VII(a), VII(c), VIII and X as indicated above is struck down. The parties will pay and bear their own costs.

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Daimler Co., Ltd. v. *Continental Tyre and Rubber Co. (G.B.), Ltd.*

[1916-17] All ER Rep. 191

EARL OF HALSBURY – I am of opinion that this judgment should be reversed. In my opinion, the whole discussion is solved by a very simple proposition that in our law when the object to be obtained is unlawful the indirectness of the means by which it is to be obtained will not get rid of the unlawfulness, and in this cause the object of the means adopted is to enable thousands of pounds to be paid to the King's enemies.

Before war existed between Great Britain and Germany, an associated body of Germans availed themselves of our English law to carry on a business for manufacturing motor car tyres in Germany and selling them here in England and elsewhere, as they were entitled to do, but in doing so were bound to observe the directions which the Act of Parliament under which they were incorporated required. They were entitled to receive in the shape of dividends the profits of the concern in proportion to their shares in it. They were all Germans originally, though one afterwards became a naturalized Englishman. Now the right and proper course to deal in the matter-and I have no reason to suppose that any other course was followed - was to distribute to them rateably, according to their shares, the profits of their adventure. But this machinery, while perfectly lawful in peace time, becomes absolutely unlawful when the German traders are at war with this country. I confess it seems to me that the question becomes very plain when one applies the language of the law to the condition of things when war is declared, between the German who is in the character of shareholder and in control of the company. They can neither meet here nor can they authorize any agent to meet on any company business. They can neither trade with us nor can any British subject trade with them. Nor can they comply with the provisions for the government of the company which they were bound by their incorporated character to observe.

Under these circumstances it becomes material to consider what is this thing which is described as a "corporation." It is, in fact, a partnership in all that constitutes a partnership except the names, and in some respects the position, of those who I shall call the managing partners. No one can doubt that the names and the incorporation were but the machinery by which the purpose (giving moneys to the enemy) would be accomplished. The absence of the authority to issue the writ is only a part of the larger question. No one has authority to issue a writ on behalf of an alien enemy because he has no right himself to sue in the courts of a King with whom his own Sovereign is at war. No person or any body of persons to whom attaches the disability of suing under such circumstances can have authority, and to attempt to shield the fact of giving the enemy the money due to them by the machinery invented for a lawful purpose would be equivalent to inclosing the gold and attempting to excuse it by alleging that the bag containing it was of English manufacture. I observe the Lord Chief Justice says that the company is a live thing. If it were, it would be capable of loyalty and disloyalty. But it is not; and the argument of its being incapable of being loyal or disloyal is founded on its not being "a live thing." Neither is the bag in my illustration "a live thing." And the mere machinery to do an illegal act will not purge its illegality-*fraus circuitu non purgatur*. After all, this is a question of ingenious words, useful for the purpose for which they were designed, but wholly incapable of being strained to an illegal purpose. The limited liability was a very

useful introduction into our system, and there was no reason why foreigners should not, while dealing honestly with us, partake of the benefits of that institution, but it seems to me too monstrous to suppose that for an unlawful, because, after a declaration of war, a hostile, purpose the forms of that institution should be used, and enemies of the State, while actually at war with us, be allowed to continue trading and actually to sue for their profits in trade in an English court of justice.

There are one or two observations which I think it right to make upon this very singular performance. This is a joint appeal partly upon a judgment under Ord. 14, partly upon a cause - ***Continental Tyre and Rubber Co. (Great Britain), Ltd.*** **v.** ***Thomas Tilling, Ltd***. [112 L.T. 324] tried before Lush, J. With respect to Ord. 14, it is almost ludicrous to treat seriously an order made under such circumstances as these, and that observation is sufficiently proved by the short history of this litigation. The second observation I have to make is that if this question turned only upon the question of the secretary's authority to issue the writ, I should certainly not be contented with the position in which that question was left. In the somewhat flippant evidence given by Mr. Wolter, it was stated that the secretary was given authority, and a minute recorded of the fact; but in the absence of the learned judge some search was made for the minute in question, and no such document could be found. I will say no more, since the witness was not again brought before the learned judge, and, therefore, had no opportunity of explanation, but I certainly would not act upon evidence such as I have described. I am, therefore, of opinion that this appeal should be allowed, and I so move your Lordships. I would like to add that I by no means desire to minimize the value of the weighty judgements to be delivered by your Lordships, but I have thought it important that all may understand the principle that the unlawfulness of trading with the enemy could not be excused by the ingenuity of the means adopted.

LORD ATKINSON – This is an appeal from an order of the Court of Appeal, dated Jan. 19, 1915, affirming an order of Scrutton, J., dated Nov. 27, 1914, made in an action brought in the name of the respondent company (a private company) to recover from the appellant company on a specially indorsed writ, dated Oct. 23, 1914, a sum of 5,605 16s., with interest, the amount due on three bills of exchange drawn by the former company and accepted by the latter. The legal question for decision is whether the order appealed from, made upon additional evidence not before the master or Scrutton, J., is right. I, therefore, abstain from considering whether, in the events which have happened, this appeal is now necessary for the protection of the appellant company.

On Oct. 30, 1914, the respondents issued a summons pursuant to R.S.C., Ord. 14, for leave to sign final judgment in the action. Affidavits were filed on behalf of both the parties litigant respectively in support of and in opposition to the respondents' application. Master Macdonell, upon the affidavits and the documents made exhibits by them, made an order of Nov. 24, 1914, granting the leave asked for. Presumably the memorandum or articles of association of the respondent company were brought before the master and examined by him, as they should have been, although this does not appear on the face of the proceedings. On appeal from this order by the appellant company, Scrutton, J., presumably on the evidence before the master, made the order already mentioned, dismissing the appeal and upholding the

order of the master. An appeal was heard in the Court of Appeal, together with an appeal raising somewhat the same questions arising out of an action brought by the present respondents against a third company, Thomas Tilling, Ltd. (reported 112 L.T. 324), tried before Lush, J., without a jury. It does not appear from the appendix what were the particular issues raised in that action, but it certainly would appear that not only was the evidence given in it by one of the plaintiffs' witnesses, the secretary, referred to and relied upon by the lords justices in the appeal in the present case, but the findings of the learned judge at the trial were apparently also relied upon against the present appellants as if they had been parties to the suit in which those rulings were made. The evidence of the secretary was, however, much relied on by both sides in argument before your Lordships. Strange as it may appear, the minute book of the company, showing presumably from what centre the business of the company was managed and directed, was not given in evidence before any one of the three tribunals. The embarrassing and, as I think, rather unfortunate result of this omission is, that the full facts, showing in what country-England or Germany-lay the real business centre from which the governing and directing minds of the company or its directors operated, regulating and controlling its important affairs, were, save so far as revealed in the evidence of its secretary, never disclosed. These are, however, the very things which, for the purpose of income tax at all events, have been held to determine the place of residence of a company like the respondent company, so far as such a fictitious legal entity can have a residence: ***De Beers Consolidated Mines, Ltd.*** **v.** ***How***e. And I can see no reason why for the purpose of deciding whether the carrying on by such a company of its trade or business does or does not amount to a trading with the enemy they should not equally determine its place of residence. It is well established that trading with the most loyal British subject, if he be resident in Germany, would, during the present war, amount to trading with the enemy, and be a misdemeanour if carried on without the consent of the Crown, the reason being that thereby he might furnish resources against his own country: ***M'Connell*** **v.** ***Hector***. The same principle would presumably apply to a trading company resident in an enemy country. It would certainly appear to me, therefore, that, having regard to the issue raised in this suit, the residence of the respondent company was of necessity a vital matter for consideration. During the argument a passage was read out from the shorthand writer's notes of the argument before the Court of Appeal, from which it appeared that the leading counsel for the Daimler Co., Ltd., admitted that the residence of the respondent company was in England. He could not well do otherwise, since the company was registered and incorporated in England, and all the facts going to show where it really resided were, with the exception already mentioned, shut out from the view of the court. It by no means follows, however, that, despite that admission of counsel, your Lordships could not, if sufficient facts were disclosed in evidence before you, hold that the residence of the company was not in England, but, in truth, in Germany.

In ***Crump*** **v.** ***Cavendish,*** Thesiger, L.J., dealing with the above-mentioned Ord. 14, said:

> "He [the judge] has to form an opinion on the facts before him, and is to stay his hand only if he is satisfies that the defendant has a good defence upon the merits, or thinks the facts disclosed by the defendant sufficient to entitle him to be permitted to defend the action."

I turn to the affidavits and documents before the master and Scrutton, J., to consider whether the facts therein disclosed were sufficient to entitle the appellant company within this rule to be permitted to defend the action brought against them. What are those facts ? They are (i) that the 25,000 shares into which the capital of the respondent company is divided are held by five individuals and a joint stock company called the parent company; that this company, incorporated and resident in Hanover, holds 23,398 of these shares, that the three individuals who hold between them 1,600 shares are all German subjects resident in Hanover; that the two remaining shares are held, one by the secretary, Hans Frederick Wolter, and one by the managing director, Paul Scharnhost Brodtmann, both according to the list of shareholders having residences in England; (ii) that the directors, three in number, excluding the managing director, are also German subjects resident in Hanover; (iii) that, with the exception of the secretary, all the directors and shareholders are German subjects; that the secretary is also a German, but, unlike the others, took out naturalization papers on Jan. 1, 1910; (iv) that the appellant company were ready and willing to pay the amount sued for on two conditions-first, that in doing so they were not acting in contravention of the provisions of the Trading with the Enemy Act, 1914 and, second, that the respondent company were able to institute this action and also were entitled to give a good and valid discharge for the amount claimed; (v) that it is averred that the so-called parent company controlled the respondent company; that the former and all the officers of the latter are alien enemies, that alien enemies who were officers or agents of the company were incapable of acting either in the name of, or on behalf of , the company, or individually; that the appellant company were advised and believed that the respondent company were incapable of instituting proceedings or giving receipts for sums due to them, or doing any of those acts which must be done through agents or officers, unless and until agents and officers who were not alien enemies have been appointed; that for these reasons the proceedings were wrongly instituted, and that unconditional leave to defend should be given.

The affidavit making these averments distinctly challenged the right of the respondent company, or any of its officers acting on its behalf, to institute the present action, or to give a valid discharge for the amount claimed by it. Their secretary filed an affidavit in reply. He contented himself with asserting that his company is an “English company, being registered at Somerset House under the Companies (Consolidation) Act, 1908, and that he himself is a British subject, having been naturalized on Jan. 1, 1910.” He adds lengthy paragraphs relative to his dealings with the Committee on Trade, with sales made to the War Office, with the payments made to his company by some others of its creditors, but not a word as to the place where its important business was conducted, or from which its action was directed by its governing minds, and not a syllable as to his ever having been authorized by the directors, or any of them, or any person connected with the company, to institute actions of any kind on its behalf. This, if ever, was the time for him to have disclosed the fact that he was clothed with authority to bring this action, if the fact were so. In my view, his silence, on the assumption that he had the authority, is inexplicable. It was greatly pressed in argument that Lush, J., had, in the action tried before him, come to the conclusion that the secretary was a truthful, though a forgetful and inaccurate, witness, and also that he had authority to institute the suit against Thomas Tilling, Ltd. I have the utmost confidence in any conclusion at which that learned judge would arrive on the evidence given before him. These affidavits were, as I understand,

not before him, and it is, in my view, quite unjust to press against the appellant company the conclusions arrived at by Lush, J., without the light which this unaccountable reticence throws on the secretary's character and veracity.

[His Lordship considered the articles of association of the respondent company and the evidence, and said that there was not a scrap of writing of any kind given in evidence to prove that any power to institute actions or give receipts for money recovered was ever conferred upon the secretary of the company. The only document he referred to as conferring it upon him contradicted every statement made by him on the point. It seemed incredible that he ever was clothed with the power, without consulting his directors or managing directors, to institute in the name of the company any actions of any kind he pleased. There was no proof other than his own testimony that he ever instituted any action or gave instructions for its institution. The burden of proving that the secretary had power and authority to institute the present action some months after the outbreak of the war rested on the respondent company. He (His Lordship) was clearly of opinion that they had not discharged that burden.]

Having formed this opinion, I do not desire to express any opinion on the other and main point raised in the case further than to say that, the question of residence of the company apart, I do not think that the legal entity the company can be so identified with its shareholders, or the majority of them, as to make their nationality its nationality or their status its status, so completely as to make it an alien enemy because they are alien enemies, or to give it an enemy character because they have that character. I think the judgment of Lord Macnaghten in ***Janson* v. *Dricfontion Consolidated Mines, Ltd*** is inconsistent with any such view. Speaking of a Transvaal company, he said:

> "If all its members had been subjects of the British Crown the corporation itself would have been none the less a foreign corporation and none the less in regard to this country an alien."

I think it is much to be regretted that the appellant company were not permitted to defend, as, in my opinion, they should have been, so that all the facts might have been elicited, and it could be determined whether the company resides and trades in Germany or not. I think the order suggested by my noble and learned friend Lord Parker should be made.

LORD SHAW – The Daimler company is indebted to the Continental company in certain sums of money. It was willing to pay these sums if payment could have been made with safety. The Continental company took legal proceedings to recover the moneys. To these proceedings the Daimler Company tabled two defences. The first is that payment would be of the nature of trading with the enemy, and the second is a challenge of the authority to institute the action. Upon the first point I am of opinion that the judgment of the Court of Appeal is right. Upon the second point and with regret I am of opinion that it is erroneous.

The first point is of much general importance : it was carefully and anxiously argued. My views upon it in its general aspect and apart from the statutes and proclamations-which were the subject of a keen analysis and which are afterwards referred to-may be expressed in the following propositions. Before stating them, however, may I say that I have found myself to be in substantial agreement with Lord Parmoor in the judgment about to be pronounced by

him, supported, as in my humble opinion it is, by the authorities which he has cited and which I do not here repeat. The propositions I have mentioned are these. (i) There is no debate at this time of day on the general proposition that the direct and immediate consequence of a declaration of war by or against this country is to make all trading with the enemy illegal. The proposition was dealt with recently in this House in ***Horlock* v. *Beal***. War is war, not between Sovereigns or governments alone. It puts each subject of the one belligerent into the position of being the legal enemy of each subject of the other belligerent; and all persons bound in allegiance and loyalty to His Majesty are consequently and immediately, by the force of the common law, forbidden to trade with the enemy Power or its subjects. (ii) This obligation and restraint is binding in every sense. It is therefore, no defence to a breach of the duty to forbear from trading with the enemy that the act was done, not for personal benefit or advantage, but in the service or under the agency or orders of another who is not so bound. No one subject to the laws of this country could be permitted to escape from obedience thereto by pleading that he was acting merely as the hand of others, say a German, Austrian, or Turkish company. The prohibition against trading is binding in regard to all action direct or indirect, personal or representative. (iii) In so far as the obligation and restraint imposed by the common law are rested upon the allegiance or loyalty of the subject, the application of such ideas to a limited company is incongruous; allegiance and loyalty are personal, by the nature of the case. An incorporated company cannot with propriety have such terms applied to it, as if it were a mind subject to emotions or passions or a sense of duty. It is a creation of the law convenient for the purposes of management, of the holding of property, of the association of individuals in business transactions, in short for all the purposes and with the limitations and remedies set forth in the Companies Acts. (iv) Once, however, it is clear that, although this may be so under proposition (iii), yet that under proposition (ii) every individual subject to the common law is inhibited and interpelled from trading with the enemy, then trading with the enemy on behalf of a company is just as much prohibited as personal trading. A limited company, incorporated in England and although English as regards all the results which flow from such incorporation, is thus completely barred by the Trading with the Enemy Acts-not by reason of the company's allegiance or loyalty, but by reason of the fact that there is no human agency possible within the realm through which, and within the law, trading with the enemy could be accomplished. In obedience to that law all trading with the enemy, direct or indirect, stops; no firm or company wheresoever or howsoever directed can so trade, nor can anything be negotiated or transacted for it through any person or agency in this country. (v) Transactions and trading require two parties, and the same principle applies to trading by the enemy as to trading with the enemy. In this way a company registered in Britain may have shareholders and directors who are alien enemies. Transactions or trading with any one of them become illegal. They have no power to interfere in any particular with the policy or acts of companies registered in Britain; alien enemy shareholders cannot vote; alien enemy directors cannot direct; the rights of all these are in complete suspense during the war. (vi) As to shareholders or directors who are not alien enemies, they stand *pendente bello* legally bereft of all their coadjutors who are. And, if the company be a company registered in Great Britain, they must face the situation thus created by adopting the courses suitable either under the Companies Acts or the recent legislation. In this way, while no payments of assets, dividends, or profits can be made to alien enemy shareholders, yet the property and business of the company may

be conserved. There may be loss consequent on commercial dislocation, but neither loss nor forfeiture is imposed by the law. The law is completely satisfied if in the conduct and range of the business trading with the enemy is avoided. To put in a word one plain instance : All British trading by the company is still permitted if there are British shareholders who can carry it on. With much respect I see no advantage to be gained, but much confusion to result, from proceeding to a further stage and treating or even characterizing British registered companies as either alien enemies or companies with an alien enemy character. As stated, all the enemy shareholders rights being placed in suspense and all trading with these shareholders or with any other enemy being interpelled, there is no principle of law which would in my humble opinion, justify the incongruity of denominating or regarding the company itself as enemy either in character or in fact.

Much of the discussion at your Lordships' Bar-probably the major part of it-had reference to the recent legislation. This was minutely and anxiously analysed. I think it necessary accordingly to deal with it; but I may say at once that I do not think that it invades or varies any of the principles which I have humbly ventured to sketch. The question, however, with whom this trading is forbidden is one of wide and serious importance. So much of the commerce of the country is now carried on by incorporated companies that it is manifestly critical for the citizen to know what is the scope of the term "enemy," and if it can apply to such companies, and if so to which of them. This is all the more so because the legislation upon the subject almost at its opening creates trading with the enemy a misdemeanour. The obligation under the common law is backed by criminal sanction. Once such a statute is passed it would, of course, not be open to any citizen to plead his ignorance of the law of the land as a defence against the charge of misdemeanour. This, however, makes it clear that courts of law should give a strict interpretation to statutory provisions of this character-an interpretation which in any case of dubiety or ambiguity shall be favourable to the liberty of the subject. Speaking for myself, I do not find that the Trading with the Enemy Acts and proclamations now to be considered were such as to leave any substantial doubt in the mind of the citizen as to what should be his attitude with regard to incorporated companies.

By the Trading with the Enemy Act, 1914 [repealed by Trading with the Enemy Act, 1939] it was provided, s. 1(2):

> "For the purposes of this Act a person shall be deemed to have traded with the enemy if he has entered into any transaction or done any act which was at the time of such transaction or act prohibited by or under any proclamation by His Majesty dealing with trading with the enemy for the time being in force or which by common law or statute constitutes an offence of trading with the enemy : Provided that any transaction or act permitted by or under any such proclamation shall not be deemed to be trading with the enemy."

There was much discussion as to this proviso. It appears to me to be a proviso applicable to the whole of the sub-section, and, if so, applicable to all transactions or acts of trading which either by common law or by this or any other statute constitute trading with the enemy. This, in my view, is equivalent to a statutory declaration that every transaction or act permitted under proclamation shall, notwithstanding all such common law or statutory prohibitions not be deemed to be trading with the enemy. I look upon this statute as one for

direction and guidance; and it does not appear to me legitimate to contend that the direction and guidance were not of this character-that if a thing was permitted by a proclamation it was not trading with the enemy or a contravention of the law. The statute was dated Sept. 18, 1914; and the question accordingly is: What did the proclamation then in force-namely, that of date Sept. 9-provide ? It provided, art. 5:

> "From and after the date of this proclamation the following prohibitions shall have effect (save so far as licences may be issued as hereinafter provided), and we do hereby accordingly warn all persons resident carrying on business or being in our dominion : (1) Not to pay any sum of money to or for the benefit of an enemy."

There occurs in art. 3 of the proclamation a definition of enemy. It is as follows:

> "The expression 'enemy' in this proclamation means any person or body of persons of whatever nationality resident or carrying on business in the enemy country, but does not include persons of enemy nationality who are neither resident nor carrying on business in the enemy country. In the case of incorporated bodies, enemy character attaches only to those incorporated in an enemy country."

It appears to me that this was a plain guide and instruction to persons in the position of the appellants. They were told first that a transaction permitted under the proclamation should not be deemed trading with the enemy; secondly, that in the case of incorporated bodies enemy character attached to those incorporated in an enemy country; but, thirdly, that it attached only to those. I think, in short, that it was very plain intimation that if a company was not incorporated in an enemy country, but was incorporated in our own country, then this was, though negatively expressed, the exact case in which a payment to such a company become unexceptionable and legitimate.

It is not to be forgotten that under the very same statute provisions were enacted to cover the case of companies whose share capital or directorate was either wholly or in certain proportion held by alien enemies. By s. 2 (2), for example, in the case of such companies, when a third or more of the issued share capital or the directorate was so held, the Board of Trade might obtain authority to inspect the books, &c., and appoint an inspector. By s. 3 further cautionary provisions were made giving to the Board of Trade power to apply to the court for the appointment of a controller. So that-to carry the legislation no further than the one Act of Parliament referred to-it was clear that the case of companies held by a majority or even by a minority of alien enemies was put under surveillance to such an extent that payments made or transactions carried on with such a company in this country would have been under official inspection. It appears to me to be a somewhat strong proposition under these circumstances to hold that one is entitled to go behind the English incorporation of the company and to declare that all these statutory stipulations were vain, seeing that such a company was an enemy, to trade with whom, directly or indirectly, was a misdemeanour. Further, it appears to me to be equally unsound for a court of law to announce that, notwithstanding all those statutory provisions, the law of the land is such that the shareholding of a company incorporated in England has to be investigated, and trading with it is forbidden if the substantial majority of shares is found to be, say, German. Such an operation would write out a large portion of the statute. It would render meaningless the

particular proviso which declared that enemy character attached only to companies incorporated in an enemy country. It is also fairly clear that under the word "substantially" every kind of inquiry would have to be made in individual instances, say, for instance, as to whether there were enough of alien enemy shareholders to make it an alien enemy company; as to whether a majority would determine the matter, with the possible result of seriously injuring large minorities of British shareholders; and, indeed, whether a company whose shares might be transferred from day to day stood to change into and out of its character as an alien enemy in consequence of the change of personnel in its shareholders. Such results would necessarily follow from upsetting the plain announcement of the statute which makes British incorporation settle high or low that the company so incorporated is not "enemy."

What happened in the present case ? Under the statute the Board of Trade did appoint an inspector. Since the beginning of August-that is since the war broke out-that inspector has initialled the cheques given by company. The company has two banking accounts, into one of which moneys received are paid. When the company receives a sum of money it gives a receipt, and that receipt, and that receipt goes through the hands of the inspector, so that he knows exactly the details. The inspector has charge of the bank account and the company is not able to pay any money to the shareholders. The fact is, that all these shareholders are German except one; but not one of these shareholders can receive under such a regime, and during the war, any part of the assets, dividends, or profits of this concern. The company has, however, a stock of rubber goods. I put to the learned counsel for the appellants what would be the result of the argument with regard to such stock; he replied that it could not be dealt with. To the further question: "If the stock were perishable?" he replied in effect that it must perish. I think that this was a perfectly logical result, but it appears to confirm the view that the argument itself was unfounded either upon the general law of the case or upon the legislation to which I have referred. I do not detain your Lordships with what I think to be the extraordinary argument that if assets are realized and a business kept up, enemy shareholders of an English company will, at the end of the war, be benefited. Possibly they may. It is true enough that on the other argument both they and the English shareholders might enormously suffer, so that a species of indirect pillage seems to be involved-pillage first of the enemy and secondly of English shareholders-thus presumably penalized for their association with others. I must respectfully decline to admit the validity of any argument of the kind. I may, however, further point out that if the statute and proclamation be construed as the Court of Appeal have, I think, very rightly construed them, the results *post bellum* would be results depending upon the state of British legislation and of the term of peace. So far as British legislation is concerned it may be mentioned that by the Trading with the Enemy Amendment Act, 1914, various provisions were made for the constitution of an office of Custodian of Enemy Property, the custodian being appointed to hold such property "until the termination of the present war," and thereafter to "deal with the same in such manner as His Majesty may by Order in Council direct" [s. 5 (1)]. In short, it seems plain beyond question that under the existing legislation or under future Acts, or as part of a diplomatic settlement after the war, the question of the disposal of enemy property will be fully dealt with. This does not seem to afford any argument in support of its deterioration or destruction, meanwhile, together with the deterioration and destruction of British rights associated with it.

In conclusion-on this head of the case-I may point out that the amending Act of 1914 provides by s. 14 that it "shall be construed as one with the principal Act," that is, the Trading with the Enemy Act, 1914, and that

> "(2) No person or body of persons shall, for the purposes of this Act, be treated as an enemy who would not be so treated for the purpose of any proclamation issued by His Majesty dealing with trading with the enemy."

It is, of course, true that this Act cannot bind the parties to the present litigation; but it appears to be entirely in accord with the view of the former Act and of the proclamation of September which has been taken in this opinion. So far as Parliament is concerned, the situation is, as stated, that the country of incorporation of the company if English excludes the company from being either an enemy company or of an enemy character : and that all the provisions relative to the working of a company whose shareholders are mixed are provisions which proceed upon that foundation. I am, accordingly, of opinion that the official of the Daimler company, charged with the payment of moneys, who would have ventured to make payment of the debt due by that company to the Continental company or to a person properly acting as its representative, would have been safe in doing so and guilty of no misdemeanour. The view taken upon this part of the case by the majority of the Court of Appeal appears to me to be well founded.

It is with regret that-this being so-I find myself constrained to concur in the opinion which your Lordships take as to the initiation of these legal proceedings. I think they naturally followed as part of a course of previous dealings; and I am not surprised at the view taken by Lush, J., in regard to this point. But, on the other hand, the point, it is only fair to the appellants to say, has been from the first raised by them. Authority to raise legal proceedings appears to be in the directors, who are all Germans, or in some person to whom they delegated the authority. They did not before the war make such delegation of authority to raise these proceedings. Since the outbreak of war it is not, according to my opinion, competent for enemy directors or shareholders to have anything to do with the management of this company's affairs in England. A different course might possibly have been adopted by the single shareholder in England. But the point against agency and authority to take these particular legal proceedings has been taken; and I do not differ from the view of your Lordships that is well founded. I agree, accordingly, to the suit being dismissed upon that ground; but if I may venture to say so, it does not appear to me to be a case in which costs should be awarded, even if such an award could be effective.

* * * * *

Lee v. *Lee's Air Farming Ltd.*

[1960] 3 All ER 420

In 1954 the appellant's husband, L., formed the respondent company for the purpose of carrying on the business of aerial top-dressing. Of the three thousand £1 shares forming the nominal share capital of the company, L. was allotted 2,999 shares. He was appointed governing director of the respondent company and pursuant to art. 33 of the articles of association was employed as chief pilot of the company at a salary arranged by him. Article 33 provided that in respect of such employment the rules of law applicable to the relationship of master and servant should apply between the company and him. In his capacity as governing director and controlling shareholder, L. exercised full and unrestricted control of the affairs of the respondent company and made all decisions relating to contracts for aerial top dressings. Different forms of insurance cover for the benefit of the respondent company and its employees were arranged by the company secretary, and certain personal accident policies were taken out in favour of L., the premiums in respect of which were paid by the respondent company and debited to L.'s personal account in the books of the company. The respondent company owned an aircraft equipped for top-dressing and L. was a duly qualified pilot. In March, 1956, L. was killed while piloting the aircraft during the course of aerial top-dressing and the appellant claimed compensation under the New Zealand Workers' Compensation Act, 1922, s. 3 (1), under which, if personal injury by accident arising out of and in the course of any employment to which the Act applied was caused to a worker, the employer was liable to pay compensation. By s. 2 of that Act, "worker" was defined as "any person who has entered into or works under a contract of service… with an employer, whether by way of manual labour, clerical work, or otherwise, and whether remunerated by wages, salary, or otherwise".

Held - L. was a "worker" within the meaning of s. 2 and the appellant was entitled to compensation under the Act, since L.'s special position as governing director and principal shareholder did not preclude him from making on the company's behalf a contract of employment with himself, nor preclude him from entering into, or working in the capacity of servant under, a contract of service with the company.

Appeal - Appeal by Catherine Lee from a judgment of the Court of Appeal of New Zealand (GRESSON, P., NORTH AND CLEARY, JJ.), dated Dec. 18, 1958, on a Case Stated by the Compensation Court of New Zealand (ARCHER, J.) pursuant to r. 5 of c. 8 of the New Zealand Workers' Compensation Rules, 1939, in an action brought by the appellant under the New Zealand Workers' Compention Act, 1922, as amended, claiming compensation of £ 2, 430 against the respondent company in respect of the death of her husband, Geoffrey Woodhouse Lee, which she alleged arose out of and in the course of his employment by the respondent company. She also claimed a sum of £50 for funeral expenses.

LORD MORRIS OF BORTH-Y-GEST - It is provided by r. 5 of c. 8 of the Workers' Compensation Rules, 1939 that:

> "In any action or other proceeding the court or a judge thereof may state a Case for the opinion of the Court of Appeal on any point of law arising in the action or proceeding."

This procedure was adopted by the judge of the Compensation Court in the action which was brought by the appellant in respect of the death of her husband. She claimed £2,430 compensation on behalf of herself and her four infant children and she also claimed a sum for funeral expenses. The claim was made in reliance on the provisions of the Workers' Compensation Act, 1922, as amended by later statutes. The appellant's late husband died in an aircraft accident in Canterbury, New Zealand, on Mar. 5, 1956, while engaged in the capacity of an aircraft pilot in aerial top-dressing operations. The claim of the appellant rested on her allegation that at the time of his death her husband was a "worker", in that he was employed by the respondent company. The respondent company denied that the deceased was a "worker" within the meaning of the Workers' Compensation Act, 1922, and its amendments. It is provided by s. 3(1) of the Act, as follows:

> "If in any employment to which this Act applies personal injury by accident arising out of and in the course of the employment is caused to a worker, his employer shall be liable to pay compensation in accordance with provisions of this Act."

Under the relevant part of the statutory definition, the term "worker" means

> "any person who has entered into or works under a contract of service or apprenticeship with an employer, whether by way of manual labour, clerical work, or otherwise, and whether remunerated by wages, salary, or otherwise."

The denial of the respondent company that the deceased was a "worker" was based on the fact that the deceased was, at the time of the accident, the controlling shareholder and governing director of the respondent company. In 1954 the deceased had instructed a firm of public accountants in Christchurch to form a company for the purpose of conducting an aerial top-dressing business. On August 5, 1954, "Lee's Air Farming Ltd.", the respondent company, was incorporated. The nominal capital of the respondent company was £3,000 divided into three thousand shares of £1 each. The deceased was allotted 2,999 shares; the remaining share according to the memorandum of association, was to be taken by a solicitor. The articles of association included the following:

> "32. Subject as hereinafter provided Geoffrey Woodhouse Lee shall be and he is hereby appointed governing director and subject to the provisions of cl. 34 hereof shall hold that office for life and the full government and control of the company shall be vested in him and he may exercise all the powers and authorities and discretions vested in the directors generally and that notwithstanding he is the sole director holding office and he may exercise all the powers of the company which are not by statute required to be exercised by the company in general meeting and any minute entered in the minute book of the company's proceedings signed by the governing director shall, in any matter not expressly required by statute to be done by the company in general meeting have the effect of a resolution of the company.
>
> 33. The company shall employ the said Geoffrey Woodhouse Lee as the chief pilot of the company at a salary of £1,500 per annum from the date of incorporation of the company and in respect of such employment the rules of law applicable to the

relationship of master and servant shall apply as between the company and the said Geoffrey Woodhouse Lee.

34. The governing director may retire from office upon giving one month's notice in writing of his intention so to do, and the office of governing director shall be vacated if the governing director (a) ceases to be a director by virtue of s. 148 of the (Companies) Act (1933); or (b) becomes bankrupt or enters into a composition with his creditors; or (c) becomes prohibited from being a director by reason of any order made under s. 216 or s. 268 of the Act; or (d) becomes of unsound mind or becomes a protected person under the Aged and Infirm Persons Protection Act, 1912; or (e) becomes incapable of carrying out the duties of a director.

35. The governing director may at any time convene a general meeting of the company.

36. The governing director shall not be disqualified by his office from holding any office or place of profit in the company or from contracting with the company whether as vendor, purchaser or otherwise, nor shall any such contract or arrangement or any contract or arrangement entered into by or on behalf of the company in which the governing director shall be interested be avoided nor shall the governing director be liable to account for any profit realised by any such contract or arrangement by reason of the governing director holding such office or of the fiduciary relations thereby established.

37. If and whenever there shall cease to be a governing director the number of directors of the company shall not be more than four or less than two who shall forthwith be appointed or elected by the company in general meeting.

38. A director need not hold any share qualification in the capital of the company.

43. No director shall be disqualified by his office from holding any office or place of profit under the company or under any company in which this company shall be a shareholder or otherwise interested or from contracting with the company either as vendor purchaser or otherwise nor shall any such contract or any contract or arrangement entered into by or on behalf of the company in which any director shall be in any way interested be avoided nor shall any director be liable to account to the company for any profit arising from any such office or place of profit or realised by any such contract or arrangement by reason only of such director holding that office or of the fiduciary relations thereby established but it is declared that the nature of his interest must be disclosed by him as provided by s. 155 of the Companies Act, 1933."

The deceased was appointed governing director of the respondent company and the secretary was Mr. Sugden, a public accountant, and a member of the firm of public accountants who had been instructed by the deceased to form the respondent company. On Aug. 16, 1954, art. 33 was amended by deleting the words "a salary of £ 1,500 per annum from the date of incorporation of the company" and inserting the words "a salary to be arranged by the governing director". That resolution was effected by a minute signed by the deceased.

The Case Stated recorded that one of the assets of the respondent company was an "Auster" aircraft equipped for top-dressing, and that the deceased was a duly qualified pilot. The Case further recorded that, while the respondent company was in the course of being incorporated, Mr. Sugden negotiated and obtained different forms of insurance cover for the benefit of the respondent company and its employees. Mr. Sugden supplied to the insurance brokers an employers' statement of wages relative to employers' liability insurance pursuant to s. 8 of the Workers' Compensation Amendment Act, 1950, and duly received an assessment of premium. Certain personal accident policies were taken out in favour of the deceased; the premiums in respect of these were paid by the respondent company and were debited to the personal account of the deceased in the books of the respondent company. Under the provisions of the Workers' Compensation Amendment Act, 1950, every employer of a worker in any employment to which the Act of 1922 applied was (subject to certain exceptions) under obligation to insure with an authorised insurer against his liability to pay compensation and was required to deliver a statement of wages to such authorised insurer.

Certain other findings recorded in the case stated were as follows:

> "10. Following its incorporation the (respondent) company started operating its aerial top-dressing business and the deceased worked for the (respondent) company as its pilot continuously thereafter until his death on Mar. 5, 1956.
>
> 11. On July 8, 1955, the said Clyde Leslie Sugden forwarded to the said brokers an employers' statement of wages for the year ended Mar. 31, 1955, and on the same date wrote a letter to the said brokers discussing the apportionment of the salary of the deceased. A copy of the said letter is annexed hereto. The relevance of the said letter was that a higher premium was payable on that part of the salary of the deceased attributable to his work as a pilot.
>
> 14. In his capacity as governing director and controlling shareholder of the (respondent) company the deceased exercised full and unrestricted control of the affairs of the (respondent) company and he expressly or impliedly authorised the acts and conduct of any other employee or officer of the (respondent) company including the said Clyde Leslie Sugden.
>
> 15. In his capacity as aforesaid the deceased made all decisions relating to contracts for aerial top-dressing, contract prices, the manner in which the (respondent) company's aircraft was to be employed and the methods to be employed in carrying out the work of the (respondent) company, and in general he exercised complete and unfettered control over all the operations of the (respondent) company at all material times.
>
> 16. On Mar. 5, 1956, while the deceased was piloting the said Auster aircraft during the course of aerial top-dressing operations in Canterbury the said aircraft stalled and crashed to the ground and burst into flames and was destroyed and the said deceased was killed as a result of the crash.
>
> 17. The (appellant) and her said four infant children were totally dependent on the deceased and the salary payable to the deceased up to the time of his death was such that if the (respondent) company is liable in this action it must pay the said sums of £ 2,430 and £50 claimed by the (appellant) in the action."

The question which was raised for the opinion of the Court of Appeal was whether at the time of his accident the deceased was employed by the respondent company as a "worker" within the meaning of the Workers' Compensation Act, 1922, and its amendments. The case stated came on for hearing in the Court of Appeal of New Zealand (GRESSON, P., NORTH and CLEARY, JJ.) on Nov. 27, 1958, and the reasons for judgment were delivered by NORTH, J., on Dec. 18, 1958. In the course of his judgment, the learned judge said:

> "We interpret the question to mean whether on the admitted facts of this case the deceased could hold the office of governing director of the company and also be a servant of the company."

Their Honours answered "the question in its amended form" in the negative. The formal judgment records the judgment in these words:

> "This court doth answer in the negative the question raised in the Case Stated and as amended by this court namely whether on the admitted facts of the case the deceased could hold the office of governing director of the company and also be a servant of the company."

The Court of Appeal recognised that a director of a company may properly enter into a service agreement with his company, but they considered that, in the present case, inasmuch as the deceased was the governing director in whom was vested the full government and control of the respondent company he could not also be a servant of the respondent company. After referring in his judgment to the delegation to the deceased of substantially all the powers of the company, NORTH, J., said:

> "These powers were moreover delegated to him for life and there remained with the company no power of management whatsoever. One of his first acts was to appoint himself the only pilot of the company, for although art. 33 foreshadowed this appointment, yet a contract could only spring into existence after the company had been incorporated. Therefore, he became in effect both employer and worker. True, the contract of employment was between himself and the company, but on him lay the duty both of giving orders and obeying them. In our view, the two offices are clearly incompatible. There could exist no power of control and therefore the relationship of master-servant was not created."

The substantial question which arises is, as their Lordships think, whether the deceased was a "worker" within the meaning of the Workers' Compensation Act, 1922, and its amendments. Was he a person who had entered into or worked under a contract of service with an employer? The Court of Appeal thought that his special position as governing director precluded him from being a servant of the respondent company. On this view, it is difficult to know what his status and position was when he was performing the arduous and skilful duties of piloting an aeroplane which belonged to the respondent company and when he was carrying out the operation of top-dressing farm lands from the air. He was paid wages for so doing. The respondent company kept a wages book in which these were recorded. The work that was being done was being done at the request of farmers whose contractual rights and obligations were with the respondent company alone. It cannot be suggested that, when engaged in the activities above referred to, the deceased was discharging his duties as

governing director. Their Lordships find it impossible to resist the conclusion that the active aerial operations were performed because the deceased was in some contractual relationship with the respondent company. The relationship came about because the deceased, as one legal person, was willing to work for and to make a contract with the respondent company which was another legal entity. A contractual relationship could only exist on the basis that there was consensus between two contracting parties. It was never suggested (nor, in their Lordships' view, could it reasonably have been suggested) that the respondent company was a sham or a mere simulacrum. It is well established that the mere fact that someone is a director of a company is not impediment to his entering into a contract to serve the company. If, then, it be accepted that the respondent company was a legal entity, their Lordships see no reason to challenge the validity of any contractual obligations which were created between the respondent company and the deceased. In this connexion, reference may be made to a passage in the speech of LORD HALSBURY, L.C., in ***Salomon* v. *Salomon & Co***. [(1897) A.C.22, 33]:

> "My Lords, the learned judges appear to me not to have been absolutely certain in their own minds whether to treat the company as a real thing or not. If it was a real thing; if it had a legal existence, and if consequently the law attributed to it certain rights and liabilities in its constitution as a company, it appears to me to follow as a consequence that it is impossible to deny the validity of the transactions into which it has entered."

A similar approach was evidenced in the speech of LORD MACNAGHTEN when he said:

> "It has become the fashion to call companies of this class 'one man companies'. That is a taking nickname, but it does not help one much in the way of argument. If it is intended to convey the meaning that a company which is under the absolute control of one person is not a company legally incorporated, although the requirements of the (Companies) Act of 1862 may have been complied with, it is inaccurate and misleading: if it merely means that there is a predominant partner possessing an overwhelming influence and entitled practically to the whole of the profits, there is nothing in that that I can see contrary to the true intention of the Act of 1862, or against public policy, or detrimental to the interests of creditors."

Nor, in their Lordships' view, were any contractual obligations invalidated by the circumstance that the deceased was sole governing director in whom was vested the full government and control of the respondent company. Always assuming that the respondent company was not a sham, then the capacity of the respondent company to make a contract with the deceased could not be impugned merely because the deceased was the agent of the respondent company in its negotiation. The deceased might have made a firm contract to serve the respondent company for a fixed period of years. If within such period he had retired from the office of governing director and other directors had been appointed his contract would not have been affected. The circumstance that, in his capacity as a shareholder, he could control the course of events would not in itself affect the validity of his contractual relationship with the respondent company. When, therefore, it is said that "one of his first acts was to appoint himself the only pilot of the company" it must be recognised that the appointment was made by the respondent company and that it was none the less a valid

appointment because it was the deceased himself who acted as the agent of the respondent company in arranging it. In their Lordships' view, it is a logical consequence of the decision in ***Salomon* v. *Salomon & Co.*** that one person may function in dual capacities. There is no reason, therefore, to deny the possibility of a contractual relationship being created as between the deceased and the respondent company. If this stage is reached, then their Lordships see no reason why the range of possible contractual relationships should not include a contract for services and if the deceased, as agent for the respondent company, could negotiate a contact for services as between the respondent company and himself there is no reason why a contract of service could not also be negotiated. It is said that therein lies the difficulty, because it is said that the deceased could not both be under the duty of giving orders and also be under the duty of obeying them. But this approach does not give effect to the circumstance that it would be the respondent company and not the deceased that would be giving the orders. Control would remain with the respondent company, whoever might be its agent to exercise the control. The fact that so long as the deceased continued to be governing director, with amplitude of powers, it would be for him to act as the agent of the respondent company to give the orders does not alter the fact that the respondent company and the deceased were two separate and distinct legal persons. If the deceased had a contract of service with the respondent company, then the respondent company had a right of control. The manner of its exercise would not affect or diminish the right to its exercise. But the existence of a right to control cannot be denied if once the reality of the legal existence of the respondent company is recognised. Just as the respondent company and the deceased were separate legal entities so as to permit of contractual relations being established between them, so also were they separate legal entities so as to enable the respondent company to give an order to the deceased.

An illustration of the validity of transactions entered into between a company comparable to the respondent company and its sole governing director is found in ***Inland Revenue Comrs.* v. *Sansom*** [(1921) 2 K.B. 492]. Sansom sold his business as a going concern to a private company, John Sansom, Ltd. He became the sole governing director of the company and the whole direction, control and management of the business and affairs of the company were in his hands. The company made large profits but no dividends were ever declared. He was the only director. The capital of the company was £25,000 divided into 2,500 shares £10 each. Sansom held 2,499 shares and had given one share to someone who had previously been employed by him. By its memorandum, the company had power to lend money to such persons and on such terms as it should think fit. The company made what were described in the balance sheets as "loans or advances" to Sansom. They were made without interest and without any security. Sansom was assessed to supertax on the loans; he was so assessed on the basis that the amounted received by him were in fact not "loans or advances" but constituted an income received by him from the company. Sansom appealed to the commissioners. They found that the company was a properly constituted legal entity; that it had power to make loans to such persons and on such terms as it should think fit; that it did make such loans to Sansom; and that such loans did not form part of Sansom's income for the purposes of supertax. On appeal by the Crown on a Case Stated, the judge (ROWLATT, J.) made an order remitting the case to the commissioners to find whether, in point of truth and in fact, the company did carry on the business or whether Sansom really carried it on to the

exclusion of the company; whether, if the company did carry on the business, it carried it on as agent for Sansom who was to be regarded as a principal standing outside the company; whether the company carried on the business on its own behalf and for the benefit of the corporators. On appeal to the Court of Appeal, it was held that the findings of the commissioners being on questions of fact were conclusive and involved the negativing of the questions which the judge had directed to be put to them; accordingly, the order remitting the case to the commissioners were discharged. In his judgment, YOUNGER, L.J., said:

> "It is conceded that the entire property in this business was bought and paid for by the company, that it passed to the company nearly ten years ago, that every transaction thereafter was carried out by and in the company's name, and has now been carried to completion in a liquidation regularly constituted. In those circumstances unless the company's legal status is to be denied to it - and this is expressly disclaimed by the learned judge - there appears to me to be no room on this case as stated for directing any such inquiry."

He further said:

> "In my judgment so long as such a company as this was is recognised by the legislature there can be no reason why the contracts and the engagements made in its name or entered into on its behalf, and themselves *ex facie* regular, should not everywhere until the contrary is alleged and proved be regarded as the company's..."

An illustration of circumstances in which a person may possess dual roles is seen in ***Fowler* v. *Commercial Timber Co., Ltd.*** [(1930) 2 K.B. 1]. In that case, the plaintiff was appointed managing director of the defendant company (which was not a so called "one man company") for a period of years. The company did not prosper, and the time came when it became clear that, if it were not voluntarily wound-up, it would be compulsorily wound-up. The directors, including the plaintiff, resolved that it was desirable to wind-up the company voluntarily. An extraordinary general meeting was called at which the plaintiff was present, and it was unanimously resolved to wind-up the company voluntarily. The liquidators gave the plaintiff notice that his agreement was terminated and that his services were no longer required. He claimed damages for wrongful dismissal, and it was held that there was no implied term in his agreement that he should lose his right to recover damages for breach of his agreement if the company went into voluntary liquidation with his assent or approval. SCRUTTON, L.J., said:

> "Such a complicated term cannot be implied for this reason: the two positions of the plaintiff (1) as managing director, who claims damages for breach of the contract of employment, and (2) as a director and shareholder of the company who thinks that in its own interests the company ought to stop business are quite consistent."

In the present case, their Lordships see no reason to doubt that a valid contractual relationship could be created between the respondent company and the deceased, even though the deceased would act as the agent of that company in its creation. If such a relationship could be established, their Lordships see no reason why it should not take the form of a master and servant relationship. The facts of the present case lend no support for the contention that, if a contract existed, it was a contract for services. Article 33 shows that what

was designed and contemplated was that, after its incorporation, the respondent company would, as a master, employ the deceased, as a servant, in the capacity of chief pilot of that company. All the facts and all the evidence as to what was actually done point to the conclusion that what purported to be a contract of service was entered into and was operated. Unless this was an impossibility in law, then the deceased was a worker within the statutory definition as referred to above. It is said that the deceased could not both give orders and obey them and that no power of control over the deceased was in existence. It is true that an inquiry whether a person is or is not employed on the terms that he will, within the scope of his employment, obey his master's orders may constitute an important inquiry if it is being tested in a particular case whether there is a contract of service as opposed to a contract for services. But in the present case their Lordships can find nothing to support the contention that there was, or may have been, a contract for services but not a contract of service.

Ex facie there was a contract of service. Their Lordships conclude, therefore, that the real issue in the case is whether the position of the deceased as sole governing director made it impossible for him to be the servant of the respondent company in the capacity of chief pilot of that company. In their Lordships' view, for the reasons which have been indicated, there was no such impossibility. There appears to be not greater difficulty in holding that a man acting in one capacity can give orders to himself in another capacity than there is in holding that a man acting in one capacity can make a contract with himself in another capacity. The respondent company and the deceased were separate legal entities. The respondent company had the right to decide what contracts for aerial top dressing it would enter into. The deceased was the agent of the respondent company in making the necessary decisions. Any profits earned would belong to the respondent company and not to the deceased. If the respondent company entered into a contract with a farmer then it lay within its right and power to direct its chief pilot to perform certain operations. The right to control existed even though it would be for the deceased, in his capacity as agent for the respondent company, to decide what orders to give. The right to control existed in the respondent company and an application of the principles of ***Salomon* v. *Salomon & Co***. demonstrates that the respondent company was distinct from the deceased. As pointed out above, there might have come a time when the deceased would remain bound contractually to serve the respondent company as chief pilot though he had retired from the office of sole governing director. Their Lordships consider, therefore, that the deceased was a worker and that the question posed in the case stated should be answered in the affirmative.

* * * * *

In re Sir Dinshaw Maneckjee Petit Bari

AIR 1927 Bom. 371

MARTEN, C.J. – For the financial year 1925-26, the assessee Sir Dinshaw Petit has been assessed for super-tax on an aggregate income of Rs. 11,35,302 arising in the previous year. Of this sum he objects to Rs. 3,90,804 made up of two sums of Rs.2,76,800 and Rs. 1,14,004, the former of which arises from Government and other fixed interest bearing funds, and the latter from dividends in companies. Nothing appears to turn on this distinction, and I shall accordingly ignore it. Admittedly the assessee is the legal owner of most of these funds in the sense that they stand in his name and the interest and dividends are paid to him direct. Admittedly as regards the rest the apparent legal owners are his nominees and he receives the interest and dividends. Admittedly he has retained all the above interest and dividends and applied the same to his own use. But he contends that he is only a trustee for certain family companies which he has formed: that the interest and dividends are theirs and not his: that he has credited them in account, and that though he has had the benefit of them in specie this is because the family companies have lent him these moneys at interest which he has credited to them in account although he has not actually paid the interest in cash. He says that the family companies are under no obligation to declare a dividend, and are entitled to lend out their income in this way, even though it results over a series of years in the fixed preference dividends being unpaid and a large sum representing back income being accumulated in the hands of the assessee.

The Advocate General on the other hand contends that the alleged disposition by the assessee in favour of each family company is a sham as is also the declaration of trust that the transactions are all paper transactions and not real. That if the family company carries on any business, it does so solely as the agent of the assessee, and that in any event the alleged loans are not genuine loans. He consequently claims that the sums in dispute represent taxable income of the assessee under Ss. 2(15), 3, 6, 12, 55, 56 and 58 of the Indian Income-tax Act, 1922.

In consequence of this dispute, the Commissioner of Income-tax has stated a case for our opinion on the four questions of law submitted in para 15. Question (4) deals with the genuineness of the alleged loans, but in para 33 the Commissioner explains the basis on which he has submitted this question, although in one sense it may be said to be a question of fact.

Turning to the facts it appears that in the year 1921 the assessee formed four private companies which I will call family companies for convenience of reference, although in fact no other member of his family took any direct benefit thereunder. The names of these four companies were Petit Limited: The Bombay Investment Company Limited: The Miscellaneous Investment Company: and the Safe Securities Limited: Each of these companies took over a particular block of investments belonging to the assessee. But as the *modus operandi* was substantially the same in each case it will suffice to follow out the fortunes of Petit Limited.

Taking then Petit Limited as an example, this family company was incorporated about April 12, 1921, with a nominal capital of rupees ten millions divided ultimately into 9,99,900

ordinary shares of Rs. 10 each and one hundred preference shares of Rs. 10 each carrying a fixed cumulative preferential dividend of six per cent. Its issued and subscribed capital consists of 3,48,604 fully paid ordinary shares all held by the assessee, and three fully paid preference shares held by three persons who are alleged in para 24 of the case to be his subordinates and to be entirely under his control, the first being the Secretary of the Petit Charities, the second being the Secretary of the four family companies, and the third being a clerk in the same companies. Its primary object as set out in Clause 3(1) of its Memorandum of Association was to enter into agreement of April 12, 1921 Exhibit B, under which the assessee sold to the family company 498 shares in Maneckji Petit Manufacturing Company Limited for Rs. 34,86,000 at the rate of Rs. 7,000 per share in consideration of the family company allotting him 3,48,600 fully paid shares of Rs. 10 each in its capital.

By a contemporaneous indenture of April 12, 1921, Exhibit C, the assessee executed a declaration of trust which recited an agreement that the 498 shares should not be transferred until the family company should call upon the assessee to do so, and that in the meanwhile the assessee and his nominees would hold the 498 shares as agents and trustees of this family company. The testatum then contained a formal declaration of trust of these shares by the assessee for the family company and an agreement by him to cause his nominees to make a similar admission. The schedule showed that of these 498 shares, 254 stood in his name and 200 in the name of his wife, and the rest in the names of some thirteen nominees. It is common ground that hitherto no formal transfers have been called for by the family company. Consequently the formation of the family company has made no difference to the names in which these 498 shares are held on the register of the Maneckji Petit Manufacturing Company Limited.

As regards the interest and dividends on the 498 shares, admittedly they have been ultimately paid to the assessee throughout. Taking for example the entries of September 10, 1924, in the books of the family company itself the cash book shows a receipt of Rs. 24,900 for a half year's dividend and is then debited to the current account of the assessee. This current account also contains a debit of Rs. 40,549 in respect of interest due by the assessee on the alleged moneys of the family company as shown in the journal entry Exhibit G. It also shows a total debit balance against the assessee of Rs. 7,14,103 which is included in the balance sheet Exhibit I. Accordingly, on the assessee's own showing the family company has been accumulating all its past income by handing it over to the assessee at interest with the result that by December 31, 1924, the total had reached Rs. 7,14,103. It has not even paid its preference dividend of in all Rs. 30 per annum on the three preference shares held by the three subordinates of the assessee. It, however, purported in its balance sheet Exhibit I to set aside rupees six lacs to a Depreciation and Reserve fund Account. This, says, counsel for the assesse, was a wise provision for the rainy day. And indeed ***Burland* v. *Earle*** [(1902) A.C. 83] may be cited as an authority for the proposition that in general a company is entitled to place profits to a depreciation or to a reserve fund, and that dissentient shareholders in the absence of a declaration of dividend or bonus or a winding-up cannot challenge the decision of the majority provided the powers are exercised *bona fide*.

So much for the accounts. I need not go into them in any greater detail. It suffices to say that the dividends on the 498 shares remained in fact with the assessee from first to last. All the rest represented book entries which might represent the truth or might not.

As for the family company itself, its activities were of the most modest description, despite the thirty-eight objects mentioned in its memorandum. Indeed apart from the primary object of entering into the above agreement with the assessee it has done little or nothing except to vary it in an important particular by the declaration of trust. There has been no additional buying or selling as contemplated by Object 2. The 498 shares remain as they were in the safe hands of the assessee or his nominees. So does the income also. The company has been too timid to indulge in any active business. It has been content to be a holding company, and as counsel for the assessee truly points out, there is no general law against that.

Turning to the Articles of Association they give the assessee complete control as governing director and indeed there is no other director, for Article 96 which prescribes a minimum of two directors only applies if there is no governing director. Accordingly, under Articles 120 and 93 he may exercise all the powers of the company not required to be done at a general meeting. This would, I think, enable him to lend money under object 4. But dividends have to be declared by a general meeting. The fiduciary position of the assessee is to be no bar to the company being bound by the agreement though, having regard to Article 95, it is perhaps not clear that Article 103 enabling directors to contract with the company applies to the assessee. The audited accounts when approved by a general meeting are to be conclusive except as regards errors discovered within three months.

It is clear, then, that the company has to act as the assessee wills, provided the terms of the Indian Companies Act are complied with. But here I wish to emphasize the warning which Younger, L.J. gave in ***Inland Revenue Commissioners* v. *Samson*** [(1921) 2 K.B. 492]:

> "Now, speaking for myself, I do in the light of these considerations, deprecate in connexion with what are called one-man companies the too indiscriminate use of such words as simulacrum, sham, or cloak – the terms found in this case – or indeed any other term of polite invective. Not only do these companies exist under the sanction, even with the encouragement of the Legislature, but I have no reason whatever to doubt that the great majority of them are as *bona fide* and genuine as in a business sense they are convenient and suitable media for the provision and application of capital to industry. No doubt there are amongst such companies, as amongst any other kind of association, black sheep; but in my judgment such terms of reproach as I have alluded to should be strictly reserved for those of them and of their directors who are shown to deserve condemnation, and I am quite satisfied that the indiscriminate use of such terms has, not infrequently, led to results which were unfortunate and unjust, and in my judgment there is no case for their use."

And then at pp. 516-7, the learned Judge says:

> "In my judgment so long as such a company as this was is recognised by the Legislature there can be no reason why the contracts and the engagements made in its name or entered into on its behalf, and themselves *ex facie* regular, should not everywhere until the contrary is alleged and proved be regarded as the company's

and not those of somebody else, any more than there is any reason why the contracts and engagements and transactions, say even of such a company as the London and North Western Railway Company, should not be regarded as regular until the contrary is shown. To my mind it is strange that it should be necessary to insist upon this aspect of the case at this time of day. But until it is fully realised the loyal adherence to the principles of ***Salomon*** case [(1897) A.C. 22], to say nothing of obedience to the declared policy of the Legislature - which is required of all Courts - will not be forthcoming."

This brings me then to the law on the points in dispute, and I may preface my observations by saying that I have almost been brought up as it were on ***Salomon*** case for when I was a pupil in the Chambers of Mr. R.J. Parker, he, with the independence and clarity of thought which afterwards characterised his judgments on the Bench, advised that the decisions first of Mr. Justice Vaughan Williams and afterwards of the Court of Appeal were erroneous in law – a view which was afterwards upheld by the House of Lords. I am, therefore, not likely to depart now from the principles of ***Saloman*** case even though I am in a different land. It is indeed one of the foundations of modern Company law, and until one can grasp the true significance of the legal entity thus created by Statute, much must remain dim to the understanding of those grappling with the subject.

Let us start then clearly with this that there was here a company duly incorporated under the Indian Companies Act and that this company was a separate entity from the assessee Sir Dinshaw Petit, just as much as, say, his secretary or any other third party might be. But because there was this separate entity which I will call X, it does not necessarily follow that every alleged transaction between the assessee and X was valid or that it represented a real transaction. We in this country are extremely familiar with the benamidar. Benami transactions abound, for they are employed extensively to hide the truth from inquisitive eyes. For instance, in a mofussil appeal last term we had a case of the truth being hidden for over thirty-seven years the *modus operandi* being for many years a sham mortgage, and later on for even greater security a sham sale to a third party. In that particular case the motive was to defeat creditors, should a speculative business prove unfortunate. No doubt in many cases the rules of evidence prevent the parties to the instrument from giving oral evidence to show that the document is not what it purports to be. But these rules do not prevent the Crown from enquiring into the truth in the present case, for, in my judgment, S. 92 of the Indian Evidence Act does not apply.

It is contended by counsel for the assessee that we are bound to accept the agreement Exhibit B, and declaration of trust Exhibit C of April 12, 1921, as effecting in law what they purport to effect. In my judgment, that contention is erroneous. Whether the separate entity is a company or an individual matters little or nothing in this respect. With the company just as with the individual you may start with the presumption that a duly executed transfer is a genuine document. But you may yet eventually find on proper evidence that in fact it was an instance of the sham transfer which we are all familiar with in the case of individuals, even though the transaction ends with the formal registration of the document before the Registrar, and the handing over of the purchase consideration in cash in his presence – cash which is conveniently provided by a third party for a few hours or minutes, and which will be restored

to him after the conclusion of the ceremony before the Registrar. It is on a par with funds provided for what is known as "window dressing purposes" in the City of London at the close of a particular financial period. And as regards the point I am now on, I see no vital difference between cash in the shape of coin or notes on the one hand and shares on the other hand. Coin or notes are more easy to manipulate, for coin cannot easily be traced and notes probably will not be in this country. Shares can be traced, but they have this advantage over coin that only a printing press is requisite. And should the transaction be upset, it only means that the shares will never in law have left their slumber as uncalled or nominal capital, or at any rate must be restored to their slumber. There is consequently no risk of any one depriving any of the parties of what does not really matter, viz., the coin or notes of the Realm.

But though I hold that it is permissible in law for the Crown to enquire into the genuineness, the transactions between the assessee and the family company, it would be quite wrong to start with the presumption that those transactions are sham ones. On the contrary one should start with the presumption that they are genuine, and throw the onus on the Crown to prove the contrary. [See Lord Justice Younger's judgment in ***Samson*** case [(1921) 2 K.B. 492] already cited. We must, therefore, look closely into the facts of the present case, and then see whether there is evidence sufficient in law to enable the Commissioner to hold – as he did hold – that the Crown had discharged that onus. Or as it might be said in a jury case whether there was in law evidence to go to the jury, and whether on that evidence a jury of reasonable men could find that in fact the transactions were sham ones.

Now the main facts here are not disputed. I have already set them out, and need not repeat them. And one striking element is that the company has never yet obtained sole legal possession and control of the property which it purported to buy. Nor can one point to clear and definite evidence that the Company is carrying on a genuine business as a separate entity. The registered agreement of sale of April 12, 1921 which was mentioned in the Memorandum and Articles of Association was an ordinary contract for the sale and purchase of a block of shares. In the natural course of events that contract should have been completed by a formal transfer and delivery of the share certificates, and the subsequent entry of the company's name as share-holder. Why then should there be the unregistered document of the same date by which the company was not to get the ordinary rights of a purchaser, and to that extent was not to carry into effect the agreement, Exhibit B, mentioned in Cl. 3(1) of the Memorandum? What advantage could the company get by being content with a declaration of trust by the vendor alone? And if it represented a genuine bargain, why should it be thus concealed from those inspecting the Memorandum or searching the Register? On the other hand, one can clearly see the disadvantages to the company by the course the alleged transaction took. Substantially the company could not begin the business contemplated by Cls. 3(2) and (3) of the Memorandum until they *de facto* acquired the shares which constituted their only asset. A law suit might be necessary to force the alleged trustee or his nominees to execute the necessary transfers or to deliver up the share certificates. And there were other risks in thus leaving all their property in the hands of a sole trustee or his nominees, for he and they could have given a good title to any third parties who presumably would be quite ignorant of the alleged but concealed trust. On the evidence before us, the company has not even got any admission of this trust by the fourteen nominees of the assessee set out in the schedules to

Exhibits B and C. For all we know they may not even be aware of it, despite the agreement by the assessee in Exhibit C that he will cause these nominees to admit the trust. It is true that the agreements set out the denoting numbers of the shares. And so the shares may be said to be earmarked as being the company's property. In this respect the copy agreements in the case stated have made a serious omission. They do not contain the denoting numbers, but I have called for the originals and find that in fact these numbers were inserted. I have also called for and inspected the file of the company kept by the Registrar of Joint Stock Companies, and I find that although neither of the original documents bears any registration mark the inference I should otherwise draw from the minute of April 12, 1921 is correct, viz., that the agreement was registered but that the declaration of trust was not registered. Should, however, the Maneckji Petit Manufacturing Company Limited have Articles of Association in a common form giving it a prior lien for advances to any individual shareholders, then it may be that the family company might be postponed should the assessee or his nominees be indebted to the Maneckji Company.

No substantial argument was advanced to us to explain why the device of this concealed declaration of trust was resorted to. One can hardly accept the excuse given to the Income-tax authorities that it was to save trouble that formal transfers were not executed. If, so, why go to the trouble of two documents Exhibits B and C instead of one? The real reason may be to preserve the assessee's voting powers in the Maneckji Company. But that is a matter again for his benefit, and not necessarily for the company's advantage. It would be quite consistent with the transaction being a sham one.

Turning next to the alleged loans of the dividends year by year to the assessee, it appears clear that it is the assessee who receives these dividends in the first instance from the Maneckji Company. There is no suggestion that the Maneckji Company has been instructed to pay those dividends to the family company. Accordingly, the rest is merely a matter of book entries, viz., to credit the cash to the company and then to transfer it to the debit of the assessee's account. The actual cash which after all is the important thing is kept by the assessee throughout. And one startling circumstance is that beyond the accounts we have nothing in writing whatever to establish the alleged agreement for loan by the family company. Of the importance of this alleged agreement there can be no doubt. By it the family company practically bound itself hand and foot to do no business, for its cash immediately on receipt was to be handed back to its vendor and promoter at a fixed rate of interest. And yet there is not even a minute on the subject. And we are asked to infer the agreement from the accounts and the yearly balance-sheets. If, however, this was a genuine agreement, why should it also not see the light of day, or at any rate find a place in the company's minute book? And none the less so because the governing director with his wide powers was purporting to lend the company's money to himself.

The result is that we have a case which is the exact opposite of ***Salomon* v. *Salomon & Co.***, in the essential facts which I am now considering. There was a genuine and prosperous business in ***Salomon*** case, viz., that of a boot and shoe manufacture. That business was transferred to the limited company, and there was no question but that thenceforth the limited company carried on that business. That the company subsequently fell on evil days was no fault of Mr. Salomon. He tried to save it, and Lord Macnaghtten expressly negatived any

fraud or dishonesty on his part. Nor was there any concealment. The creditors were, therefore, forced to argue that in effect no separate entity was created by the Statute, and that a person holding the bulk of the shares might be held liable as if he was the sole proprietor or a partner. That contention the House of Lords demolished.

So, too, in ***Inland Revenue Commissioners*** **v.** ***Sansom,*** there was a genuine timber business carried on by the limited company, which made large profits during the war. These profits were not distributed in dividend, but were alleged to have been lent to Mr. Sansom the governing director who held all the shares but one. The question was whether these loans were genuine. Sansom himself gave evidence and satisfied the Commissioners that he was telling the truth. The appellate Court confirmed their decision, and pointed out that Mr. Sansom's case was corroborated by the fact that one of the alleged loans had undoubtedly been paid by him to the family company. Here we have got nothing of that sort. The assessee has not ventured to give any evidence and the finding of the Commissioner is against the truth of his story. Nor have any of the alleged loans been repaid. If then the Court of Appeal in ***Sansom*** case had the present facts before them, I think their judgments show that a different conclusion would have been arrived at. Thus Lord Sterndale, M.R., says:

> I think it only needs the statement of those facts to show that anybody would approach the matter with a very considerable amount of suspicion and I think the *prima facie* tendency of anybody's mind would be to say - This transaction of loans or advances without security and without interest is a mere fiction. It is all nonsense, and the real fact is that Mr. Sansom was receiving under the guise of loans or advances the profits which were made by the company which he controlled and in which he held practically the whole of the impression off-hand. And that no doubt was part of but only a part of the case which was made before the Commissioners. Now the Commissioners have found that these were genuine loans, that they were loans by the company to Mr. Sansom, and that they were not mere pretences to hide the fact that he was receiving the profits of the company. They saw him; he was examined before them, and I suppose they had before them all Mr. Sansom's and the company's books and all the materials that could be provided. They are business men who I have no doubt have heard of one-man companies and are perfectly familiar with the questions which arise upon them, and they were certainly as well fitted as we are to come to a conclusion of fact in the matter. They did come to that conclusion. I shall allude to the particular terms of their findings later on, but they did come to that finding. It seems to me that for reasons which I shall give this really puts an end to this case, which, in my opinion, depends entirely upon questions of fact.

And Scrutton, L.J., says:

> That assessment came before the Commissioners, who had to decide on this point whether these were genuine loans or whether they were merely a disguise for profits of the company received by the shareholder. Now personally I feel that I should have approached the consideration of that question with the strongest presumption that they were really profits and not loans; the whole thing looks extremely suspicious. But the Commissioners saw Mr. Sansom, they heard him cross-examined, they

heard other witnesses, they heard all that could be said on either side, and they heard that in the earlier years of the company a similar loan appeared in the books which had been repaid by Mr. Sansom to the company, and after hearing all the evidence they found that these were genuine loans. Now, whatever I might have thought, not having seen the witnesses, I do not see how I can possibly interfere with a finding of the Commissioners, who are judges of fact and who have seen Mr. Sansom, that these were genuine loans.

And Younger, L.J.:

I wish, however, to express, if I may be allowed to do so, my fullest concurrence with what has fallen from Scrutton, L.J., and also from the Master of the Rolls on the question in relation to these loans, as it must have presented itself to the Crown before the case came before the Special Commissioners at all. The transactions between Mr. Sansom and the company in relation to these loans are indeed on the fact of them very singular.

Lord Justice Younger further goes on to point out the singular feature that Mr. Sansom was thus exercising his powers as governing director to lend the company's moneys to himself without interest and without security. The case for our decision presents similar features, except that the alleged loan is said to carry interest.

I next turn to ***Jacobs* v. *the Commissioners of Inland Revenue*** [(1925) 10 T.C. 1], which was a case decided in the Court of Session, Scotland, on June 4, 1925, by the Lord President (Lord Clyde) and Lord Cullen and Sands. There, again, there were genuine businesses, viz., shops carried on by the several companies in which Mr. Jacobs held substantially all the shares. Here also the profits were alleged to have been lent to Mr. Jacobs. But in this case the Special Commissioners held that the loans were not genuine loans, and the Court of Session upheld their decision. Lord Clyde in the course of his judgment stated as follows:

My Lords, in this case the question and the only question, put to us is whether the Special Commissioners were entitled to find that the sums withdrawn were part of the appellant's income and as such liable to Super-tax. We are not the Judges of Appeal on questions of fact but on questions of law only, and, therefore, the only question before us is whether the appellant can make out that upon the facts, either admitted or proved, which are itemised ...the Commissioners could legally - that is to say, could reasonably, without being unreasonable - arrive at the finding in fact which is submitted for our consideration...I confess I can find no ground at all which would justify me in saying that the Commissioners were not entitled to form the conclusion in fact at which they did arrive...I think it is probably true that it would have been better if the last part of that finding had been expressed in the same form as the earlier portions of the finding are expressed, namely, a finding that the loans were not genuine loans but were in point of fact payments drawn from the profits of these companies by the appellant and formed part of his income. But, after all, that is nothing but a question of form; it is not one of substance; I have no doubt at all that on the facts, admitted or proved, there was ample ground upon which the Commissioners could reasonably arrive at the result which they reached, and that is

enough for the decision of the only question put to us. I think the question ought to be answered in the affirmative.

That case seems to me very close to the present one, except that here we have not got a company carrying on an open business like a shop. The circumstances, therefore, are more unfavourable to the assessee.

If, however, the genuineness of the alleged transfer or declaration of trust is once admitted, there is another class of case which is clearly set out in the judgment of Scrutton, L.J., in ***Sansom*** case at p. 507, and which raises:

> The question whether it can be said that the business which is being carried on by a company is really the business of an individual and consequently the profits made by that company are really his profits, and he is assessable in respect of them.

In the American brewery cases, for instance, it has been held that the business carried on in America ostensibly by an American company was really the business of the English company which held all the shares, it was held that the profits of the foreign company were not the profits of the English company, and that the English Company was not carrying on the business of the foreign company.

In the present case, however, the part played by the quarrelsome and independent Mr. Hime in ***Sansom*** case fall to the lot of three subordinates of the assessee. But they can hardly be said to be in the same independent position as Mr. Hime, and there is no suggestion that they are quarrelsome. They have not even been paid their preference dividends, and no protest on their part is on record. Further, we have here a feature which is not present in the other cases, viz., that the alleged transfer or declaration of trust is itself challenged.

It was argued for the assessee that in England legislation became necessary to defeat the device of accumulating profits and refusing to declare a dividend; and that we are really being asked to do what legislation alone can enable us to do. But that argument does not touch a sham transfer nor a sham loan. And in any event I think it is erroneous in the present case. This is not the first time when plausible paper schemes under the Companies Acts have not stood the test of examination in a Court of Law. And even if it should be held that the payment of the moneys to the assessee was illegal without a declaration of dividend, it may yet be that the assessee would be liable for tax as was the case of the bookmaker in ***Partridge*** **v.** ***Mallandaine*** [(1886) 18 QBD 276], or as regards the illegal abwabs in ***Birendra Kishor Manikya*** **v.** ***Secretary of State*** [AIR 1921 Cal. 262].

On the other hand, the fact that the family company has paid tax on the interest credited to it by the assessee in respect of the alleged loans does not necessarily involve the conclusion that the loans were genuine, nor estop the Crown from now showing that these loans were illusory. Paying tax on the alleged interest arising from the loan was much cheaper for the assessee than paying super-tax on the dividends themselves.

After giving then my best consideration to the able arguments presented by counsel, I have arrived at the clear conclusion that there was here in law evidence on which the Commissioner might reasonably find as a fact (1) that there was no genuine transfer or declaration of trust in favour of the family company, and (2) that the alleged loans were not

genuine loans. I would, accordingly, hold on questions, Nos. 1 and 4 that in law the Commissioner was entitled on the facts to decide question No. 1 in the affirmative and question No. 4 that the loans in question were not genuine loans but were merely withdrawals of income disguised as loans.

Questions Nos. 2 and 3 should each be answered in the negative.

Speaking for myself, I would prefer to confine my judgment to the path indicated for the High Court in S. 60 (5) of the Indian Income-tax Act 1922, viz., the decision of the questions of law raised in the case stated by the Commissioner. But as the Commissioner to some extent invites our opinion on the facts, and as it may be argued that one or other of the questions is a mixed question of law and fact, I may be permitted to add that on the law and the facts, I would answer question No. 1 in the affirmative, and question No. 4 by holding that the loans in question were not genuine loans but were merely withdrawals of income disguised as loans. Accordingly, in my judgment, the sums in dispute represented taxable income of the assessee under the Indian Income-tax Act, 1922.

KEMP, J. – This is a reference under S. 66(2) of the Indian Income-tax Act, 1922, and involves the consideration of the legal entity known as a "one-man company." The assessee is a well-known and wealthy citizen of Bombay and the assessment relates to the financial year 1925-26.

The four limited liability companies are of the same nature and were formed in the same way. The four companies are (1) Petit Limited, (2) the Bombay Investment Company Limited, (3) Miscellaneous Investment Company Limited, and (4) Safe Securities Company Limited. It will be sufficient for the purposes of the reference to take as a typical case the first company, Petit Limited. I may here say that out of the total subscribed capital of over thirty to forty lacs of each company, only shares of the face value of Rs. 30 were not in the assessee's name. These last were in the names of his employees, who are under his control. All the shares and securities stand in the name of the assessee or his nominees but the assessee says that they belong to the companies.

Taking the case of Petit Limited, it was a company which was registered on April 12, 1921, with a capital of one hundred lacs divided into ten lacs of shares of Rs. 10 each. There was one hundred preference shares and the remaining 9,99,900 shares were ordinary shares. The issued capital is 3,48,604 ordinary shares and three preference shares. The three preference and four ordinary shares were paid for in cash, i.e., Rs. 70. The assessee took up all the other ordinary shares. The three preference shares were allotted: one to the secretary, Petit Charities, one to the secretary of the four companies, and one to the clerk of the four companies. The assessee held 498 shares some in his own name and some in the names of his nominees of the Maneckji Petit Company of the value of Rs. 7,000 each. By an agreement dated April 12, 1921, the assessee purported to sell these shares to the company in return for the allotment of the company's shares, i.e., for 3,48,604 ordinary shares.

Then by a declaration of trust of the same date in favour of Petit Ltd. in which it is recited that it was agreed that the shares and securities were not to be transferred until the Company called upon the vendor to do so but that in the meantime the vendor and his nominees should

hold the respective shares standing in their respective names as agents and trustees for the company, the vendor stood possessed of the shares upon trust for the company and agreed to cause all his nominees to admit that they held the shares in their names as trustees for the company. No transfers have been called for by the company. What happened subsequently was this. As soon as the dividend and interest on the shares and securities were received by the assessee a book entry was made in the books of Petit Limited crediting that company with the amount and on the same day a debit entry was made debiting the assessee with the same amount. In other words the interest never found its way into Petit Limited but when received by the assessee was treated as an advance made to him by the company

At the date of the last balance sheet a sum of over rupees seven lacs is shown as due by the assessee in the books of Petit Limited for these alleged advances and accrued interest. It may be mentioned that no interest was paid in cash but the interest was added to the amount of the loans in the books of Petit Limited. The only cash, therefore, which Petit Limited received was the Rs. 70 for the three preference and four ordinary shares.

The Memorandum of Association of the company contains thirty-eight objects for which it was formed and a perusal of the Articles of Association, especially Articles 4, 6, 34 and 93, shows that the governing director of the company, i.e., the assessee himself, had a paramount say, in the affairs of the company. It was possible for two other ordinary directors to be nominated by him but, so far as the evidence before us goes, no such directors have been nominated and in fact the governing director, i.e., the assessee, has had the entire control and management of the company. No remuneration was paid to him as governing director. The meeting of the so-called board to record the company's registration was attended only by the assessee himself as governing director and the solicitor to the company.

The Income-tax Commissioner contends that this is not a genuine one-man company and that the dividends on the shares and securities are really the income of the assessee.

Now this was a one-man company. It was properly formed and registered as a company under the Indian Companies Act and it had a separate legal entity. There was nothing *prima facie* illegal about it.

Here in India, as I have already pointed out, limited liability companies are liable to super-tax but at a rate which is very much less than the rate of super-tax on the income of individuals. It is, therefore, obvious that it was to the assessee's interest that the dividends and shares should be considered as belonging to the company rather than to himself. The well-known case of ***Salomon* v. *Salomon & Co.*** shows that where there is a genuine transfer by an individual of his business to a limited liability company consisting even of himself and his family so long as the business carried on by the company is its business and is really not the business carried on by the individual himself and the requirements of the Indian Companies Act have been complied with, the individual is not liable to indemnify the company against the claims of its creditors.

I have already referred to the control which the assessee in this case exercised under the Articles of Association and as the holder of all the issued ordinary shares in this company. The three preference shares were held by his nominees and employees. A perusal of the current account in the company's books shows that the dividends and interest alleged to have

been received by the company were credited in the limited share account of the company and the same day debited to the assessee by way of loan. As I have pointed out none of the dividends or interest ever reached the company. Only credit and debit entries were made. Nor was any interest paid on the amount of the loan standing to the assesses' debit in the books of the company but the interest was credited every year to the company in the account. Here I may properly deal with the contention that because the Income-tax Authorities have hitherto treated the dividends and interest as part of the income of the company, they are now estopped from contending otherwise. In my opinion, they are not barred from claiming on an investigation of the true facts of the case that the profits of the company are really the income of the assessee liable to super-tax.

There are other facts which suggest that the company in this case was formed by the assessee purely and simply as a means of avoiding super-tax and that the company was nothing more than the assessee himself. It did no business but was created purely and simply as a legal entity to ostensibly receive the dividends and interest and hand them over to the assessee as pretended loans. In the balance-sheet as at December 31, 1914, the amount set down for depreciation and the balance on profit and loss account make up the balance standing to the debit of the assessee in his current account on January 1, 1924. The expense in the company's Profit and Loss account Rs. 15,383-11-0 are debited to the assessee's current account with the company. The whole of the dividends and interest on the shares and securities ostensibly supposed to belong to the company have been from year to year received by the assessee and merely credit and debit entries made in the company's books to support the case of a series of loans made every year to the assessee. The assessee's current account with the company shows the large amount of Rs. 7,14,103-8-11 due by him for these alleged loans and interest on them. Nothing has been repaid on this account and in this connexion it may be observed that in ***Sansom*** case the Courts found that some of the earlier loans had been repaid.

The only cash with the company is Rs. 70 made up of the amount paid for the three preference and four ordinary shares.

The shares and securities stand in the assessee's name. The agreement dated April 12, 1921, between the assessee and Petit Limited provided for the purchase of the shares by the allotment of 3,48,600 fully paid up shares. The indenture of trust recites that it has been agreed that the shares shall not be transferred until the company calls upon the vendors so to do and then proceeds to declare that the vendor shall stand possessed of shares in the company. As a matter of fact the company has not called on the vendor to transfer the shares. I agree that one may look at this case from a consideration of the question whether there has been any real trust or not, but I think the shares being in the assessee's name and the dividends having been received by him it lies on him to show in the first instance that as a matter of fact he really holds them for a company and not on his own behalf. In other words, he must show he is trustee for the company. I think he has not only failed to show this but the evidence establishes that as a matter of fact he really held the shares on his own behalf and for his own benefit whilst professing to hold them as trustee for a genuine and *bonafide* company.

The company has declared no dividends. The memorandum of association of the company contains thirty-eight objects; yet the company's activities have been restricted to the

supposed receipt of the dividends and interest on the shares and securities supposed to belong to it; and for six years the company has only received the dividends and interest by paper entries and passed it on to the assessee by way of a supposed loan. So far as the alleged loan itself is concerned, no resolution of the company has been produced to show that it was sanctioned or the rate of interest which was to be charged. It was made without security and no vouchers have been taken for the advances.

I am, therefore, of opinion that in this case the assessee was receiving under the guise of loans or advances the profits which were made by the company which he controlled and in which he held all the shares except three which were held by his subordinates. The company was created by him merely, so that he could make entries in the company's books suggesting that it received the interest and dividends and paid them as loans whilst in reality the receipt of dividends and interest, if it could be called the business of the company, was its only business and was in fact the business of the assessee himself.

This really disposes of the argument put forward by counsel for the assessee that if these moneys received by his client were not loans they were moneys wrongfully received by him which he is bound to refund to the company and on which, therefore, he is not assessable to super-tax. I am not prepared, in any case, to accede to this argument where, if the company be regarded as carrying on its own business separate to that of the assessee, it has made no attempt and apparently does not intend to recover such sums from the assessee.

Nor can the moneys received by the assessee be regarded as dividends paid by the company on its shares; for the company paid no dividends and the moneys are not entered in its books as such.

I would answer the questions: 1. In the affirmative. 2. No. 3. No. 4. They were not genuine loans but merely withdrawals of income disguised as loans.

PER CURIAM **–** *The judgment of the Court will be: Answer Question No. 1 in the affirmative: Questions Nos. 2 and 3 in the negative: and Question No. 4 by holding that the loans in question were not genuine loans but were merely withdrawals of income disguised as loans.*

* * * * *

Workmen v. *Associated Rubber Industry Ltd.*

(1985) 4 SCC 114

O. CHINNAPPA REDDY, J. – 2. The Associated Rubber Industry Ltd. had purchased, some years back, shares of INARCO Ltd. by investing a sum of Rs 4,50,000. They were getting annual dividends in respect of these shares and the amount so received was shown in the profit and loss account of the company year after year. It was taken into account for the purpose of calculating the bonus payable to the workmen of the company. Some time in the course of the year 1968, the company transferred the shares of INARCO Ltd. held by it to Aril Bhavnagar Ltd. (changed to the Aril Holdings Ltd.), a subsidiary company wholly owned by The Associated Rubber Industry Ltd. Aril Holdings Ltd. had no other capital except the shares of INARCO Ltd. transferred to it by the Associated Rubber Industry Ltd. It had no other business or source of income whatsoever except receiving the dividend on the shares of INARCO Ltd. The dividend income from the shares of INARCO Ltd. was not transferred to The Associated Rubber Industry Ltd. and therefore, it did not find place in the profit and loss account of the company with the result that the available surplus for the purposes of payment of bonus to the workmen of the company became reduced. The net result of the exercise was that bonus at the rate of 4% only was paid to the workers for the year 1969 instead of at the rate of 16% to which they would have otherwise been entitled. We may mention here that Aril Holdings Ltd. was itself wound up in the year 1971 and amalgamated with The Associated Rubber Industry Ltd.

3. The workmen of The Associated Rubber Industry Ltd., Bhavnagar raised an industrial dispute claiming that they were entitled to be paid bonus at the rate of 16% for the year 1969. According to them, the transfer of the shares of INARCO Ltd. to Aril Holdings Ltd. was no more than a device to avoid payment of higher bonus to the workmen. The Industrial Tribunal and thereafter the High Court of Gujarat under Article 226 of the Constitution, held that The Associated Rubber Industry Ltd. and Aril Holdings Ltd. were two independent companies with separate legal existence and therefore, the profits made by Aril Holdings Ltd. could not be treated as profits of The Associated Rubber Industry Ltd. for the purpose of computing the gross profits earned by The Associated Rubber Industry Ltd. It was further held that there was no evidence to show that the transfer of shares to Aril Holdings Ltd. was only a device to avoid payment of bonus to the workmen.

4. It is true that in law The Associated Rubber Industry Ltd. and Aril Holdings Ltd. were distinct legal entities having separate existence. But, in our view, that was not an end of the matter. It is the duty of the court, in every case where ingenuity is expended to avoid taxing and welfare legislations, to get behind the smoke-screen and discover the true state of affairs. The court is not to be satisfied with form and leave well alone the substance of a transaction. In ***CIT* v. *Sri Meenakshi Mills Ltd.*** [AIR 1967 SC 819], the judicial approach to such problems was stated as follows:

> "It is true that from the juristic point of view the company is a legal personality entirely distinct from its members and the company is capable of enjoying rights and being subjected to duties which are not the same as those enjoyed or borne by its members. But in certain exceptional cases the Court is entitled to lift the veil of

corporate entity and to pay regard to the economic realities behind the legal facade. For example, the Court has power to disregard the corporate entity if it is used for tax evasion or to circumvent tax obligation. For instance, in ***Apthorpe* v. *Peter Schoenhofen Brewing Co.*** [4 TC 41], the Income Tax Commissioners had found as a fact that all the property of the New York company, except its land, had been transferred to an English company, and that the New York company had only been kept in being to hold the land, since aliens were not allowed to do so under New York law. All but three of the New York company's shares were held by the English company, and as the Commissioner also found, if the business was technically that of the New York company, the latter was merely the agent of the English company. In the light of these findings the Court of Appeal, despite the argument based on ***Salomon*** case [1897 AC 22], held that the New York business was that of the English company which was liable for English income tax accordingly. In another case - ***Firestone Tyre and Rubber Co.* v. *Llewellin*** [(1957) 1 WLR 464] - an American company had an arrangement with its distributors on the Continent of Europe whereby they obtained supplies from the English manufacturers, its wholly owned subsidiary. The English company credited the American with the price received after deducting the costs plus 5 per cent. It was conceded that the subsidiary was a separate legal entity and not a mere emanation of the American parent, and that it was selling its own goods as principal and not its parent's goods as agent. Nevertheless, these sales were a means whereby the American company carried on its European business, and it was held that the substance of the arrangement was that the American company traded in England through the agency of its subsidiary."

More recently we have pointed out in ***McDowell & Co. Ltd.* v. *CTO*** [(1985) 3 SCC 230]:

> "It is up to the Court to take stock to determine the nature of the new and sophisticated legal devices to avoid tax and consider whether the situation created by the devices could be related to the existing legislation with the aid of 'emerging' techniques of interpretation as was done in ***Ramsay***, ***Burmah Oil*** and ***Dawson***, to expose the devices for what they really are and to refuse to give judicial benediction."

5. If we now look at the facts of the case, what do we find? A new company is created wholly owned by the principal company, with no assets of its own except those transferred to it by the principal company, with no business or income of its own except receiving dividends from shares transferred to it by the principal company and serving no purpose whatsoever except to reduce the gross profits of the principal company. These facts speak for themselves. There cannot be direct evidence that the second company was formed as a device to reduce the gross profits of the principal company for whatever purpose. An obvious purpose that is served and which stares one in the face is to reduce the amount to be paid by way of bonus to workmen. It is such an obvious device that no further evidence, direct or circumstantial, is necessary. It was argued that in 1971, the Aril Holdings Ltd. was wound up and amalgamated with The Associated Rubber Industry Ltd. and that this circumstance showed that the initial creation of Aril Holdings Ltd. was not a device of avoidance. Probably, after Aril Holdings Ltd. was created, some unforeseen difficulties arose which have not been brought to light before us and it became necessary to wind it up and amalgamate it with The Associated

Rubber Industry Ltd. We are therefore, satisfied that the amount of dividend from INARCO Ltd. received by the Aril Holdings Ltd. should be taken into account in assessing the gross profit of The Associated Rubber Industry Ltd. for the purpose of calculating the rate of bonus payable to the workmen of The Associated Rubber Industry Ltd. The appeal is allowed and it is declared that the workmen of the Associated Rubber Industry Ltd., Bhavnagar are entitled to be paid bonus at the rate of 16% for the year 1969.

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Gilford Motor Company, Limited v. *Horne*

(1933) Ch. 935 : [1933] All Er Rep. 109(CA)

The plaintiff company bought the various parts of motor vehicles from manufacturers, assembled the parts on the company's premises and sold the products under the name of Gilford Motor Vehicles. They also sold separate parts which were handed over to the buyers for cash. By an agreement dated May 30, 1929, the defendant was appointed managing director of the plaintiff company for a term of six years from September 1, 1928. Clause 9 of the agreement provided that: "The managing director shall not at any time while he shall hold the office of a managing director or afterwards solicit, interfere with or endeavour to entice away from the company any person, firm, or company who at any time during or at the date of the determination of the employment of the managing director were customers of or in the habit of dealing with the company." The employment of the defendant as managing director was determined in November 1931, by an agreement between the parties under which the defendant was to receive a fixed sum payable in instalments. Shortly afterwards the defendant opened a business for the sale of spare parts of Gilford vehicles. In an action by the plaintiff company to enforce the covenant:

Held (by Farwell J.), that persons buying spare parts from the plaintiff company, paying for them in cash and taking them away, would be included in the covenant; that the defendant, as managing director, would not come into contact with those customers and would not know them or their names and addresses and that, therefore, the covenant was too wide.

Held, by the Court of Appeal (reversing the decision of Farwell J.), that in the circumstances the covenant was not wider than was reasonably necessary for the protection of the plaintiff company's trade and was therefore enforceable by injunction.

For the defendants. The covenant is too wide to be enforceable. The plaintiffs sell spare parts to strangers, who pay cash for and take the spare parts away with them. Any strangers who bought spare parts in this way several times would come within the meaning of persons “in the habit of dealing with the company”. The defendant, as managing director, would not come into contact with customers of that class and would not know them, and might therefore quite innocently solicit their customers. That renders the prohibition unreasonable and makes the whole covenant bad. The tendency of the Courts is to be strict in their consideration of these restrictive covenants and to enforce only those which are formed for the protection of employers and are not unreasonable or too wide.

LORD HANWORTH, M.R. - In this case a business was carried on by the Gilford Motor Company, Ltd., which had a registered office in Holloway Road, London, and a manufacturing place in Green Lanes, High Wycombe. The business that was carried on was this: they sold motors which were assembled by them, but they were not in fact the actual manufacturers of the whole of the motors thus sold; it was rather that they assembled and then completed the motors that they sold and were able to supply spare parts for these Gilford motor-cars. The defendant, Edward Bert Horne, in May, 1929, was of primary importance in the business, and on that date the company made an agreement with him whereby he was appointed a managing director, with a right to hold that office for a term of six years from September 1, 1928; that is to say, the span for which he was engaged terminated on

September 1, 1934. There were the usual clauses in that agreement. The managing director was to devote his whole time and attention and abilities during business hours to the company and the business of the company; he was entitled to certain holidays; he was entitled to a remuneration of £1,250 a year and to a certain percentage on the profits; and during that time he was not to be, directly or indirectly, in any capacity except as a shareholder, interested in any business or company other than the Gilford Company. Then it was provided by clause 9 in terms as follows: "The managing director shall not at any time while he shall hold the office of a managing director or afterwards solicit, interfere with or endeavour to entice away from the company any person, firm, or company who at any time during or at the date of the determination of the employment of the managing director were customers of or in the habit of dealing with the company, and also will not at any time within five years from the determination of this agreement, either solely or jointly with or as agent for any other person, firm or company, be engaged, directly or indirectly in any business similar to that of the company within a radius of three miles from any premises wherein the business of the company shall for the time being be carried on." Now it is the interpretation to be given to that clause 9, which has to be decided between the parties in this action, and it is the first part of that clause, of which I have read both limbs, which is in question. What happened was this. Difficulties arose between the company and Mr.Horne, and letters passed on November 17, 1931, that is approximately some three years before the termination of the span for which the managing director was employed. The letters that passed were to this effect, that Mr. Horne tendered his resignation as a director and joint managing director of the company "on terms as arranged with you today", and those terms are set out, that there is to be a total of £1,500.; paid to Mr. Horme by instalments of three separate sums of £500.; and he concludes the letter: "I agree to accept in full discharge of all sums due to me by the company including compensation for cancellation of my joint managing director's agreement." The reply of the same date was an acknowledgment of the letter tendering the resignation and stating the Board had accepted the resignation to operate "from to-day", and it is recorded in a minute of that same day that the Board resolved to accept the resignation as a director and joint managing director of the company on terms as arranged in accordance with the letter handed in and signed by Mr. E.B. Horne. After that resignation took effect Mr. E.B. Horne established a business and carried it on at his own home, 170, Hornsey Lane, Highgate, and the business he had was one carried on by "E.B. Horne", and there is no doubt that his business was one of supplying spare parts and service for all models of the Gilford vehicles. Having established himself, or attempted to establish himself, in that way as "E.B. Horne", he became anxious as to whether or not what he was doing was in contravention of the agreement which he had entered into and to which I have referred, and so it was that on March 29, 1932, his solicitor wrote this letter to the Gilford Motor Company: "Dear Sirs, I am acting for Mr. E.B. Horne, the late joint managing director of your company, and I understand that he entered into certain agreements with your company as to service and for sale. As I am desirous of advising him upon the terms of these agreements, I shall be glad if you will be good enough to forward copies to me, and accept this letter as my undertaking to pay your reasonable charges for such copies. Yours faithfully, J.R. Cort Bathurst." The reply on March 30 was: "We are in receipt of your letter of yesterday's date, and in reply would inform you that Mr. E.B. Horne's copy of the original service agreement with this company was left with

the writer for safe custody; therefore we have pleasure in enclosing it herewith." Thus the solicitor was on March 30 placed in possession of the agreement of which I have read some and indicated other portions of the terms. Following upon that reply of March 30, 1932, on April 8 a limited company under the title of "J.M. Horne" was incorporated. It was incorporated as a private company. The paper which had been previously "E.B. Horne" was altered by blacking out the initials of Mr. E.B. Horne, "E.B.", and inserting at the commencement "J.M." and adding "and Co. Ltd. " Now it so happens that "J.M." are the initials of the wife of Mr. Horne. That company is a private company, as I have already said; its primary objects are to carry on the business of factors' agents and distributors and vendors and buyers of accessories and spare parts of all classes of vehicles, and so on and for charabancs, motor-cars, taxis, and so on. The registered office is at the private address of Mr. Horne, 170 Hornsey Lane; the directors are Jessie May Horne, the wife of Mr. E.B. Horne, and Mr. Albert Victor Howard, a person who had been, as I understand, originally in the employ of Gilford Motors, but who was at that time associated with Mr. E.B. Horne in the business which he carried on after November, 1931. The nominal capital was £500 divided into 500 shares of £1 each, and the allotments that were made on April 12 were, as to 101 shares, to Mrs. J.M. Horne, and 101 shares to Mr. A.V. Howard. The solicitor of the company was the writer of that letter of March 29 which I have already read.

Farwell J. heard the evidence about that company and had these documents before him. He says this:

> "The defendant company is a company which, on the evidence before me, is obviously carried on wholly by the defendant Horne. Mrs. Horne, one of the directors, is not, so far as any evidence I have had before me, taking any part in the business or the management of the business. The son, whose initials are 'J.M.', is engaged in a subordinate position in that company, and the other director, Howard, is an employee of the company. As one of the witnesses said in the witness-box, in all dealings which he had had with the defendant company, the 'boss' or the 'guvnor', whichever term is the appropriate one, was the defendant Horne, and I have not any doubt on the evidence I have had before me that the defendant company was the channel through which the defendant Horne was carrying on his business. Of course, in law the defendant company is a separate entity from the defendant Horne, but I cannot help feeling quite convinced that at any rate one of the reasons for the creation of that company was the fear of Mr. Horne that he might commit breaches of the covenant in carrying on the business, as, for instance, in sending out circulars as he was doing, and that he might possibly avoid that liability if he did it through the defendant company. There is no doubt that the defendant company has sent out circulars to persons who were at the crucial time customers of the plaintiff company."

Now I have recalled that portion of the judgment of Farwell J., and I wish in clear terms to say that I agree with every word of it. I am quite satisfied that this company was formed as a device, a stratagem, in order to mask the effective carrying on of a business of Mr. E.B. Horne. The purpose of it was to try to enable him, under what is a cloak or a sham, to engage in business which, on consideration of the agreement which had been sent to him just about

seven days before the company was incorporated, was a business in respect of which he had a fear that the plaintiffs might intervene and object.

Now this action is brought by the plaintiffs, the Gilford Motor Company, Ltd., to enforce the terms of clause 9 of the agreement of May 30, 1929, on the ground that the defendant Horne, and the company, as his agent and under his direction, have committed breaches of the covenant which I have read. Admission has been made quite frankly and candidly in this Court, as it was made below, that there have been circulars sent out to the customers of the Gilford Motor Company. The statement is made in the evidence in these terms: "It is admitted now, I gather - although my learned friend says it is small, that does not seem to me to matter, with respect - that persons were solicited by Mr. Horne, both before and after the formation of the company, who were customers of the plaintiff company at the time he was in its service. That is right, is it not?" and Sir Walter Greaves–Lord says: "That is right." So that the learned judge was on sure ground when he said there was a clear admission that these two defendants were soliciting the customers of Gilford Motors; and, as Farwell J., puts it: "Admittedly the defendant Horne sent out circulars to various persons in which it was stated that the defendant was ready and in a position to supply spare parts for Gilford vehicles; and, in fact, he did supply spare parts and at prices which were, I gather, considerably lower that those charged by the plaintiff company, so that in a sense he was what is known as undercutting the plaintiff company." In other words, there is no defence at all to the claim made in this action unless the conduct of the two defendants can be excused on one of two grounds: firstly, that the covenant is unenforceable in law by reason of the width of its terms, or, secondly, that it has ceased to be operative by reason of the terms which were arranged between the company for the discharge or the release of the managing director from that position on November 17, 1931.

I, therefore, proceed now to consider those two points in order, and, first: Is the covenant unenforceable as being bad in law? I accept the proposition that a covenant in restraint of trade is *prima facie* one which the law will not enforce, but to that broad proposition there have been many exceptions over a very long period of time, and the famous case of ***Mitchel* v. *Reynolds*** [1 P. Wms. 181] has decided, by a judgment delivered by Lord Macclesfield, within what limits and terms the Court will enforce such agreements. The old rule was undoubtedly that it must be partial in space or partial in time, but we have to bear in mind that the nature of these agreements has been expounded in the light of later considerations which have gradually arisen as there has been an evolution or development of business transactions. As Rigby L.J. points out in ***Dubowski & Sons* v. *Goldstein*** [(1896) 1 Q.B. 478, 484]: "We have now gone far beyond what was supposed to be the law in the time of Tindal, C.J. and Lord Denman C.J. I am not surprised that at that time they expressed the opinions they did. Lord Watson has pointed out in the case of ***Nordenfelt* v. *Maxim Nordenfelt Guns and Ammunition Co***. [(1894) A.C. 535], that the opinion of the judges of this age as to matters of public policy may differ very much from that of judges of a bygone age when the circumstances of the world were different. The only test of the validity of an agreement in restraint of trade now is whether or not such an agreement is reasonably necessary for the protection of the person with whom it is made", and, as pointed out on p. 475 of the first volume of ***Smith's Leading*** cases, dealing with the ***Nordenfelt Co.*** case, which went to the

House of Lords, the true view is "that any restraint, whether general or partial, is *prima facie* invalid, but may be good if the circumstances of the case show it to be reasonable." We have, therefore, to consider: Were the terms of this covenant in clause 9 reasonable? Let me just add one further passage from ***Mason* v. *Provident Clothing and Supply Co***. [(1913) A.C. 724, 741]. Lord Shaw, in dealing with a case where the activities of a canvasser were in question, says: "A very reasonable restriction of a canvasser in such circumstances as are here disclosed might no doubt have been that he should not canvass his old customers or in the limited locality of his former labour. This the law would naturally and properly enforce, and would look upon as a reasonable protection of the employer"; and in ***Dubowski*** case: "This agreement, like all others, must be construed with regard to the surrounding circumstances. It has been objected to as being too wide in two respects: first in respect of space; secondly, in respect of time", and he holds that the objection fails in respect of those persons who were customers of the late employers at the time when the employee was in their employ.

Now I turn to this agreement. What is its purpose? It is to protect the business, the profits which are to be earned by the company with the persons, firms, or companies who at that time - the time of the employment of the defendant Horne - were customers of the company, and from whom, in the business they did with them, the company derived profit. I repudiate altogether the suggestion that you can, by reason of taking one or two words such as "the habit of dealing with the company", impute a meaning to this covenant that it deals with or covers the case of a person from whom the Gilford Motor Company buy, and in respect of whose dealings there can be no profit at all arising to the Gilford Motor Company. It is intended to deal with persons who are upon their books, or with whom they deal and, in the course of dealing, earn a profit.

Now objection is taken that these words are too wide, and Farwell J., has said that it may be that by reason of the fact that the customers are not defined, or the persons who were in the habit of dealing with the company are not particularized, a danger might accrue to this man from an innocent sale to one of such persons, and he might have been imperilled during all time, long after his employment has ceased, by the nature of such transactions. I cannot agree that such is a fair test to apply to the covenant. It appears to me that this covenant was, as in the many scores of cases in which such covenants have been upheld in these Courts, necessary for the protection of the plaintiff company's business; it operated after the determination of the employment and in respect of persons of whom the defendant himself would have the best knowledge, for he was the managing director of the company, and what it means is that he is not to solicit, to interfere with or endeavour to entice away for his advantage, customers or persons who are in the habit of dealing with the company for the company's advantage. Objection is taken that these words "customers of or in the habit of dealing with the company" either have no meaning or are tautological. I do not agree with that. It appears to me that a customer is a person who frequents a place of business for the purpose of making purchases, and those persons may be determined in a particular way by, for instance, having their names recorded in the books of the company, or they may be upon a list, but there may be other persons who are in the habit of dealing with the company but whose names have not yet been inscribed upon any register of customers, and I see no reason at all to object to the employment of both those terms by reason of the fact that one or other of

them might have covered persons who are to be found in the alternative category. Now, if that be so, it appears to me that this is a covenant which was required for the purpose of reasonably protecting the company's business. It does not go so far as to cover customers who become customers after the managing director has left, and it was a covenant entered into by him with full knowledge of what he was doing, and with full knowledge of who were the persons included in that phrase, and it is in respect of them that he is debarred from solicitation, interference or enticing away. The covenant is definite in date; it is not uncertain, because you have the time at which you are to look for the customers or persons in the habit of dealing, and you have got therefore a covenant which is reasonable in the sense of being necessary for the protection of the plaintiff company's business.

The defendant has, by his own admission, solicited persons who come within the ambit of the covenant. What is the justification? It appears to me that this is an agreement which must be upheld by the Court, and the plaintiff company are entitled to the protection of the Court, and the injunction must be granted. The question whether in any particular case some casual purchaser from the defendant may cause the defendant to be in danger of further action by the Court is quite a different question. I do not quite understand the meaning of what is called a "casual customer". I think the two words are mutually antagonistic: I think a "customer" is a person who, as I said, frequents the shop; a casual purchaser seems to be a different person. But, however that may be, we have to say that the plaintiffs are entitled in this action to have this covenant upheld, and an injunction is the proper mode of enforcing that as against these defendants.

The other ground of defence is that there has been an agreement whereby the defendant was released from the restrictive covenant. It will be observed that as the matter went before the Court the defence relied upon an oral agreement to release him, and now suggestion is made that if you look to the letters of November 17 there is a cancellation of the agreement, and the cancellation means a release from clause 9. I do not so read the letters or the entry in the minute book. It appears to me that the defendant rightly stated that there was an oral agreement, and although some of the terms which have been agreed between the parties, particularly the one under which the defendant was to receive compensation, may have been recorded in the letters, in the absence of any specific term dealing with this protective clause 9, I agree with the learned judge and do not accept the view that there has been any release of the clause. Mr. Collier strenuously argued that, inasmuch as there was a new agreement, there was a release of this clause, but that, of course, will depend upon whether or not the new agreement covered the same area that the previous agreement had done. It appears to me that the purpose of the second agreement was to deal with the question of the shortening of the term of the employment, and the compensation to be paid in consequence of that shortening, and was not intended to deal with or release the defendant from the restrictive covenant.

In these circumstances the appeal must be allowed, and for the reasons which I have already stated I think the injunction must go against the company. Sir Walter Greaves-Lord admitted that if the company were such as is indicated by Lindley L.J. in ***Smith* v. *Hancock*** [(1894) 2 Ch. 377, 385], it would not be possible to object to the injunction going against the company. Lindley, L.J., indicated the rule which ought to be followed by the Court: "If the evidence admitted of the conclusion that what was being done was a mere cloak or sham and

that in truth the business was being carried on by the wife and Kerr for the defendant, or by the defendant through his wife for Kerr, I certainly should not hesitate to draw that conclusion, and to grant the plaintiff relief accordingly." I do draw that conclusion; I do hold that the company was "a mere cloak or sham"; I do hold that it was a mere device for enabling Mr. E.B. Horne to continue to commit breaches of clause 9, and under those circumstances the injunction must go against both defendants, the appeal must be allowed with costs here and below, and the injunction will be in the terms asked in the prayer in the statement of claim.

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Subhra Mukherjee v. *Bharat Coking Coal Ltd.*

(2000) 3 SCC 312

S.S.M. QUADRI, J. – 2. The suit property was owned by M/s Nichitpur Coal Company Private Limited (hereinafter referred to as "the Company"), which is registered under the Indian Companies Act. By a resolution of the Board of Directors of the Company dated 21-9-1970, it was resolved to sell the suit property to the appellants for a consideration of Rs. 5000. However, the appellants paid Rs. 7000 to one of the Directors under receipt dated 30-12-1970. An agreement to sell the suit property to the appellants for Rs. 7000 (Rs. 5000 as consideration of the bungalow and Rs. 2000 as price of the land) was executed by the Company on 3-1-1971. The Company executed the sale deed in their favour on 20-03-1972.

3. The Coal Mines (Nationalisation) Act, 1973 came into force on 1-5-1973 and from that date the right, title and interest of the owners in relation to the coal mines specified in the Schedule appended to the Act of 1973 (the said Company is mentioned at Serial No. 133 of the Schedule) vested in the Central Government ("the vested properties"). Thereafter under the order of the Central Government, the vested properties stood transferred to and vested in the government company named M/s Bharat Coking Coal Ltd. ("BCCL"). As the appellants did not hand over the possession of the suit property to BCCL, it initiated proceedings under the Public Premises (Eviction of Unauthorised Occupants) Act, 1971 ("the PP Act") for their eviction from the suit property on 15-10-1976.

4. Being faced with eviction proceedings under the PP Act, the appellants filed the said suit against BCCL for declaration of their rights in, title to and interest over the suit property. The suit was resisted by BCCL, *inter alia*, on the ground that with effect from the appointed date the suit property vested in it and that the alleged sale transaction in favour of the appellants was sham, collusive, without any consideration and was brought into existence to avoid the effect of vesting of the suit property under the Act of 1973. It was also stated that the appellants are the wives of the Directors of the Company, who are real brothers. On appreciation of the evidence placed before it, the trial court held that the appellants got no title to the suit property and were, therefore, not entitled to any relief and thus dismissed the suit on 22-9-1977. Aggrieved by the judgment and decree of the trial court, the appellants filed Title Appeal No. 147 of 1977 before the learned District Judge, Dhanbad. On reappraisal of the evidence on record, the learned District Judge allowed the appeal and set aside the judgment and decree of the trial court and decreed the suit of the appellants, as prayed for on 6-10-1978. BCCL then unsuccessfully carried the matter, in second appeal, before the High Court of Judicature at Patna (Ranchi Bench). The judgment and decree of the High Court dismissing the second appeal on 7-10-1985, was challenged by BCCL in Civil Appeal No. 838 of 1986 in this Court. On 17-8-1993, this Court set aside the impugned judgment and decree of the High Court and remitted the matter to the High Court to decide the following two points:

> "(1) whether the transaction in question is a *bona fide* and genuine one or is a sham, bogus and fictitious transaction as held by the trial court; and
>
> (2) whether in view of Section 3 (1) read with Section 2*(h)(xi)* and the entry at Serial No. 133, in the Schedule to the Act, the property in question stood transferred to and

vested in the Central Government free of all encumbrances, on the appointed day under the Coal Mines (Nationalisation) Act."

It was observed that the result of the second point would depend on the decision of Point 1.

5. However, after remand, in view of the submission made by the learned counsel for BCCL that Point 2 was covered by the judgment of this Court in ***Bharat Coking Coal Ltd.*** **v.** ***Madanlal Agrawal*** [(1997) 1 SCC 177] the High Court decided it first. On Point 1 the High Court restored the judgment of the trial court holding that the transaction of sale between the appellants and the Company was sham and bogus and was entered into to avoid the vesting of the suit property in the Central Government under Section 3(1) of the Act of 1973 and thus allowed the second appeal filed by BCCL on 11-11-1997. That judgment and decree are under challenge in this appeal.

6. Mr. A.K. Srivastava, learned senior counsel appearing for the appellants pointed out that contrary to the observation of this Court, the High Court has proceeded to decide Point 2 first and that resulted in prejudice to the appellants. He argued that the High Court found that the appellants had proved three facts, namely, *(i)* the Board of Directors of the Company passed a resolution on 21-9-1970 to sell the suit property in favour of the appellants; *(ii)* the appellants paid Rs. 7000 to one of the Directors of the Company under receipt dated 30-12-1970; and *(iii)* the sale deed was executed by the Company on 20-3-1972. He invited our attention to the evidence of PW 8, the accountant of the Company, to prove passing of the resolution, to substantiate payment of Rs. 7000 and its entry in the books of accounts of the Company and the execution of the sale deed dated 20-3-1972 by the Company. In view of these proved facts and in the absence of any rebuttal evidence, it was contended, the High Court ought to have held that the sale of the suit property was genuine and valid.

7. Mr. Anip Sachthey, learned counsel appearing for the respondents has contended that the suit property is in the midst of the colliery and that the Directors of the Company and the appellants are no other than husbands and wives and that the transaction was entered into to save the suit property from vesting in the Central Government under Section 3 of the Act of 1973.

8. We have perused the deposition of PW 8 accountant and the impugned judgment. There can be no doubt that the High Court in para 13 of its judgment mentioned that the resolution of the Company dated 21-9-1970, receipt evidencing payment of Rs. 7000 on 30-12-1972 (Ext. 10), under which one of the Directors, the husband of Appellant 1, received the said amount and the sale deed executed on 20-3-1972, had been proved by the appellants. But, then the High Court also noted with approval the following circumstances, pointed out by the first appellate court: firstly, the resolution dated 21-9-1970 was an *ante*-dated document. Mr. Srivastava submitted that the government authorities were in possession of all the records of the Company and they should have produced the original record to substantiate the allegation that the resolution was *ante*-dated and in the absence of such record the High Court was not justified in confirming the finding of the first appellate court. The fact remains that the appellants themselves took no steps to summon the record from the custody of the authority concerned. That apart, there is no mention of the resolution dated 21-9-1970 either in the receipt (Ext. 10) signed by one of the Directors or in the agreement for sale of 3-1-1971

or in the sale deed dated 20-3-1972. On the basis of the intrinsic evidence, pointed out above, the conclusion that the resolution was an *ante*-dated document, appears to be irresistible. Secondly, it is pointed out by the High Court that though the resolution mentions the sale consideration as Rs. 5000 there is no explanation as to why it was enhanced to Rs. 7000 for which receipt was signed by one of the Directors of the Company. Thirdly, a more telling aspect is that the appellants did not exercise their rights as purchasers over the suit property till the date of the filing of the suit; the water and electricity connections were obtained during the pendency of the suit by them; further till the date of vesting of the suit property under the Act of 1973, it was maintained by the Company for the use of the Directors.

9. It is rightly commented by the High Court that the agreement for sale of the suit property is not a registered document; it recites that the suit property will be sold for Rs. 7000 even though the consideration of Rs. 7000 was paid on 30-12-1970 itself and neither the agreement nor the sale deed is in terms of the resolution.

10. Two other aspects which have weighed with the High Court are: the transaction of sale was between the husbands and the wives and that they had no independent source of their income, which cannot be ignored altogether as irrelevant.

11. Mr. Srivastava submitted that undue emphasis was given to the fact that the Directors of the Company were brothers and the appellants are their wives. He argued that the Company is a separate legal entity which is independent of its Directors and shareholders and repeatedly referred to the oft-quoted decision in ***Salomon* v. *Salomon & Co*** [(1897) AC 22]. The principle laid down in ***Salomon*** case more than a century ago in 1897 by the House of Lords that the company is at law a different person altogether from the subscribers who have limited liability, is the foundation of joint stock company and a basic incidence of incorporation both under English law and Indian law. Lifting the veil of incorporation under statutes and decisions of the courts is an equally settled position of law. This is more readily done under American law. To look at the realities of the situation and to know the real state of affairs behind the façade of the principle of the corporate personality, the courts have pierced the veil of incorporation. Where a transaction of sale of its immovable property by a company in favour of the wives of the Directors is alleged to be sham and collusive, as in the instant case, the court will be justified in piercing the veil of incorporation to ascertain the true nature of the transaction as to who were the real parties to the sale and whether it was genuine and *bona fide* or whether it was between the husbands and the wives behind the façade of separate entity of the company. That is what was done by the High Court in this case.

12. There can be no dispute that a person who attacks a transaction as sham, bogus and fictitious must prove the same. But a plain reading of Question 1 discloses that it is in two parts; the first part says, "whether the transaction in question is a *bona fide* and genuine one" which has to be proved by the appellants. It is only when this has been done that the respondent has to dislodge it by proving that it is a sham and fictitious transaction. When the circumstances of the case and the intrinsic evidence on record clearly point out that the transaction is not *bona fide* and genuine, it is unnecessary for the court to find out whether the respondent has led any evidence to show that the transaction is sham, bogus or fictitious.

13. For the afore-mentioned reasons, we are unable to say that the High Court erred in taking the view that the sale, in favour of the appellants, is neither *bona fide* nor genuine and confers no right on them.

14. In view of the finding on Point 1, the suit property remained the property of the Company and, therefore, it vested in the Central Government under Section 3(1) of the Act of 1973. This is what the High Court held on Point 2, which is supported by the judgment of this Court in ***Bharat Coking Coal Ltd.*** **v.** ***Madanlal Agarwal.*** In the result, we find no merit in the appeal. It is accordingly dismissed.

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PROMOTERS – DUTIES AND LIABILITIES

Erlanger v. *New Sombrero Phosphate Co.*

(1874-80) All ER Rep. 271

The position of promoters *vis-à-vis* the company which they are promoting is not that of trustees to a *cestui que trust*, but they are in a fiduciary position towards the company. Consequently, where the promoters of a company sell property to the company the burden is on them of showing that they have not taken any unfair advantage resulting from their relations with the company. It is their duty to nominate independent directors of the company who are capable of acting impartially in defence of the company's interests and will be competent and impartial judges whether or not the purchase ought to be made. Furthermore, they must disclose to the company all the material facts relating to the transaction. They need not disclose what they paid for the property which they are selling to the company, but they must not be guilty of any conduct which amounts to unfair concealment of the real facts of the case which ought in common fairness to be disclosed to a person seeking to purchase or entering into a treaty with them for that purpose. Where a company is not given by the promoters an opportunity of exercising, through independent directors, a fair and independent judgment on the subject of the purchase by the company of property from the promoters, the court may order the contract to be rescinded and the purchase price to be returned.

Appeal by the defendants in the action from a decision of the Court of Appeal (SIR GEORGE JESSEL, M.R., JAMES and BAGGALLAY, LL.J.), reversing a decree of MALINS, V.C., on a bill filed by the respondent company to rescind a contract for the purchase of a small island in the West Indies called "Sombrero", on the ground that all the circumstances attending the transaction had not been disclosed by the vendors, a "syndicate" of which the appellants were members, who had purchased the lease of the island, with the assent of the Court of Chancery, from the liquidator of a former company, and had re-sold it to the present company.

The plaintiff in the action in the Chancery Division was the New Sombrero Phosphate Co. Sombrero was a small island in the West Indies, about a mile and a quarter long, in which were deposits or beds of phosphate of lime. It belonged to the Crown, and a lease was made of it for twenty-one years from March 1865, at a rent of £1000. This lease was assigned, in the first instance, to a company called the Old Sombrero Co., who paid £100,000 for it, taking it subject to a mortgage of £12,400. This company was wound-up by the Court of Chancery, and in 1871, in the winding-up, the lease of the island came to be sold. The appellants, along with one Thomas Westall, a solicitor, thought well of the speculation, and wished to buy the lease, and for this purpose they formed a syndicate. On August 30, 1871, the members of the syndicate agreed to buy the lease from the official liquidator, for £55,000, the contract being made in the name of Westall on behalf of his principals. Shortly before Sept. 20, 1871, the syndicate determined to form a joint-stock company, which was registered on Sept. 21, and to sell the island to the company for £110,000. They took the necessary steps for this purpose, preparing the memorandum of association, and the articles, and also the prospectus which was to be issued. The memorandum of association stated that the object of the company was the

purchasing, leasing, and working of mines or quarries of phosphate of lime in the island of Sombrero. The articles stated that the number of directors should from time to time be determined by a general meeting, and that till any other number was determined there should be not less than four nor more than seven directors. Two directors should be a quorum for the transaction of business; and among the acts which the directors were empowered to do were the adoption and carrying into effect the contract for the assignment to the company of the island of Sombrero, dated the same day as the articles, namely, September 20, 1871. By this contract John Marsh Evans agreed to sell, and Francis Pavy agreed to purchase, the lease of the island and the property on it for £110,000, £80,000 to be paid in cash and £30,000 in fully paid-up shares of the new company. Evans was a trustee or agent for Baron Erlanger and other members of the syndicate, and Pavy was a person whose name was introduced into the contract as a matter of form, to represent the company about to be created in case it should adopt the contract. The contract was, on the fact of it, a provisional one, subject to the formation of the company and the adoption of the contract by it. In the whole of this proceeding up to this time the syndicate, or the house of Erlanger, as representing the syndicate, were the promoters of the company.

The memorandum of association of the company was signed by Evans and six other persons, all of whom were nominees of the syndicate, and none of whom was in a condition to afford disinterested protection to the interests of the company. Mr. Westall prepared the articles of association. By art. 65:

> "The number of directors shall from time to time be determined by the company in general meeting; until any other number is so determined, there shall not be less than four directors nor more than seven. The first directors shall be His Excellency Monsicur Drouyn de Lhuys, E.B. Eastwick, Esq., the Right Hon. Thomas Dakin, John Marsh Evans, Esq., and Rear-Admiral R. John Macdonald."

By art. 82:

> "In their management of the business of the company the directors may, without any further power or authority from the members, do the following things, viz., first, they may adopt and carry into effect the contract for the assignment to the company, bearing even date herewith, of the island of Sombrero, in the West Indies, and the factory, buildings, and works thereon, for the residue of a term of twenty-one years from Mar. 16, 1865, subject to the provisions contained in the lease thereof."

With regard to the five persons named as the first directors, M. de Lhuys was requested by Erlanger to act as director, and he assented. It was not pretended that he made, or was expected to make, any independent inquiry on behalf of the company. He was asked to be a director because from his position he would be influential in promoting the sale of phosphate on the continent; and he assented, trusting entirely to Baron Erlanger. His appointment, therefore, afforded no protection to the company. Mr. Eastwick had applied to Erlanger personally to be allowed to join the company, but had gone to Canada. Admiral Macdonald was stated by LORD BLACKBURN to have "evidently come into the company with a foregone conclusion that everything his friend Erlanger had done was right, and under such a bias he could afford no protection to the company." Evans was the agent of the syndicate. The

company could not, therefore, have any protection unless from Sir Thomas Dakin. He was quite disinterested and he embarked his own money in the company, but before lending his name as director he made no inquiry although he was aware that those getting up the company were the vendors of the lease.

On Sept. 29, 1871, there was a meeting of directors, attended by Sir Thomas Dakin, Admiral Macdonald, Evans, and Mr. Westall, the solicitor to the syndicate. These directors, without inquiry into facts and fi*gur*es, ratified on behalf of the company, the proposed purchase of the island. A considerable number of shareholders came forward, and in November the purchase price of the island was paid. In February, 1872, the first meeting of shareholders took place, and in June of that year a committee of shareholders was appointed to investigate the matter of the purchase. The advice of counsel was taken, the committee reported, and on Dec. 24, 1872, the company filed the bill in the present action.

LORD CAIRNS, L.C. – It is now necessary that I should state to your Lordships in what position I understand the promoters to be placed with reference to the company which they proposed to form. They stand, in my opinion, undoubtedly in a fiduciary position. They have had in their hands the creation and moulding of the company; they have the power of defining how, and when, and in what shape, and under what supervision it shall start into existence and commence to act as a trading corporation. If they are doing all this in order that the company may, as soon as it starts into life, become, through its managing directors, the purchaser of the property of themselves, the promoters, it is in my opinion incumbent upon the promoters to take care that in forming the company they provide it with an executive, that is to say, with a board of directors who shall both be aware that the property which they are asked to buy is the property of the promoters, and shall be competent and impartial judges whether the purchase ought or ought not to be made. I do not say that the owner of property may not promote and form a joint-stock company and then sell his property to it, but I do say that, if he does, he is bound to take care that he sells it to the company through the medium of a board of directors who can and do exercise an independent and intelligent judgment on the transaction, and are not left under the belief that the property belongs, not to the promoter, but to some other person.

If this is the position and duty of a promoter, I ask your Lordships in the next place to consider how far that duty was discharged by the promoters in the present case. The company was formed to purchase mines in the island of Sombrero, and the directors were armed specifically with the power of adopting the contract of Sept. 20, 1871. The promoters, in framing the constitution of the company, have themselves given us what they considered to be the proper measure of strength of a board of directors who were to be entrusted with the execution of this power. They were to be not less than four nor more than seven, and in point of fact five names were given as the first directors. They were at once to enter upon business, and the first duty they would have to perform would be to consider whether the contract should be adopted or not. How far then were they in a position to perform this duty? The first name was that of Monsieur Drouyn de Lhuys. It is not pretended that the idea was ever entertained by the promoters that he either would or could take any part in the first great act of the directors, the adoption of the contract, or that he could attend any meeting for the purpose. Of the second director named, Mr. Eastwick, the same may be said. He was absent at a

distance from England, and did not take his seat at the board till the end of December, 1871. The third director, Evans, was himself the vendor, and whether he was vendor as being beneficially interested in the property or as trustee for the syndicate, is, in my opinion, immaterial. There remained two directors only, Sir Thomas Dakin and Admiral Macdonald, and of these I will speak when I come to the first meeting of the directors.

The company was registered on Sept. 21, 1871, and the first meeting of directors took place on the 29th of that month. There were present of the directors Sir Thomas Dakin, Admiral Macdonald, and Evans. There was also present Mr. Westall, who had been appointed and was acting as solicitor for the company, but was himself one of the syndicate, although it is said that on the syndicate he merely represented certain other names not disclosed, and had himself no interest beyond the promise of a payment of £500. At this meeting a prospectus was produced, ready for issue to the public, stating that the contract for purchase had been made by the directors; and the first resolution proposed and carried, almost as a matter of course, was that the contract should be approved and confirmed. Neither Sir Thomas Dakin nor Admiral Macdonald have given evidence in the case, and it is difficult to say positively what they knew or what they inquired about that which they were professing to buy.

The conclusion at which I have arrived, from such materials as are before your Lordships, is that both Sir Thomas Dakin and Admiral Macdonald treated from the first the adoption of the contract as a foregone conclusion. But whether this was so or not, it was the duty of the promoters to take care that the contract for the purchase of their property was submitted to the intelligent consideration of a competent number of independent directors; and I cannot but regard a meeting at which two of the principal directors did not and could not attend - at which one who did attend, and take part in the deliberations, was at once a person buying and selling - where the legal adviser present and assisting was virtually another vendor, and where the two remaining directors are not shown to have had the means of exercising, or to have exercised, any intelligent judgment on the subject - as little else than a mockery and a delusion. I have said nothing as to the provision that two directors should be a quorum. That is a provision, which, in my opinion, could not be held to remedy defects such as I have pointed out as going to the entire constitution of the board.

I cannot, therefore, entertain any doubt that, if within a proper time after the completion of this purchase a bill had been filed by the company, impeaching it on the grounds that I have stated, the purchase must have been set aside. The part of the case which, however, has given me the most anxiety is the question whether, having regard to what was made known at the time that the company was formed, and to what became known, and to what also might further have become known, shortly after it was formed, and having regard further to the very peculiar nature of the property which had been purchased, and to the impossibility of restoring the parties to their original position, relief can or ought now, consistently with the principles of equity, to be given to those who seek to impeach the contract. On this question I entertain considerable doubt, or more than doubt. Under these circumstances, looking to the very peculiar nature of the property and the utter impossibility of restoring the property, and the commercial undertaking connected with it, to the vendors in the state in which it was when the company took possession of it, and looking to the amount of notice which the company had by the prospectus, and to the knowledge which they might have obtained by

pursuing the inquiries which the prospectus ought to have suggested, I am of opinion that it would be contrary to the principles of equity to give to the company the relief which at an earlier period they might have obtained.

LORD HATHERLEY – After the view which has been so clearly expressed by my noble and learned friend, I certainly feel diffidence in coming to a conclusion contrary to that which he has adopted. In the present contention between the appellants and the company there were three several heads argued as to some of which every judge who has heard the case has been agreed.

In the first place, the company endeavoured to set aside this contract on the ground of the persons who sold the property having filled a fiduciary position as actual trustees for the company which was formed, and being disentitled to participate in any profit which could be made in the sale in consequence of that trusteeship. The court below, as well as all your Lordships, have been of opinion that they were in no such sense as that trustees for the company, but that the syndicate, which was formed for the original purchase of the mines, which they did purchase under arrangements made in the winding-up of the old company, were entitled to hold that purchase as a syndicate and to deal with it as they thought proper. Consequently, any authority derived from those cases which insist that no profit can be derived by a trustee out of that which is the property of his *cestui que trust* has no application to the present case, inasmuch as the syndicate never constituted themselves trustees, but intended to sell and did sell this property to the new company or association which was about to be formed, and for the purpose of making sale they desired that the company should be formed, and took an interest in its formation. Secondly, it was urged in this case, and upon this point also the courts were agreed, that although the purchase so made was not liable to be interfered with on the ground that I have stated, as being a purchase made by persons who were trustees for the company, nevertheless it was liable, if due steps were taken at the proper time, to be impeached upon other grounds disclosed by the bill and sustained by the evidence. On that point my noble and learned friend who has just addressed the House has concurred in the view unanimously taken by the learned judges in the courts below, and I believe your Lordships are also unanimous on the point. The circumstances of this particular case are such that, if there was no delay and no laches in asserting the remedy, the remedy which the company seeks was open to them.

The question is, therefore, reduced to this point of delay, and, in considering it, I think it very important to see what the exact position of the parties was at the moment when the contract was entered into by the company. The courts of equity have at all times carefully abstained from attempting a nice definition of imposition with reference to the rights which the practice of such imposition may confer upon the parties injured by it. It is notorious that every mode that can well be conceived of dealing with contracts which ought not to be maintained in consequence of some deception which vitiates them has from time to time before the consideration of the courts of equity, and there is scarcely any one which can be set on foot that is not struck at by the general doctrines of the courts of equity, although the precise circumstances of the case may have never yet come before the court. There are three particular classes of cases of what the court terms fraud, which may be pointed to as having

some analogy with or some bearing upon the present case. The first is as between vendor and purchaser; the next is as between partner and co-partner; and the third is the case in which an agent for a purchaser receives a gratuity from a vendor. As to the first of these, a vendor need not do what was at one time asserted by this bill, namely, disclose what he has paid in effecting his own anterior purchase before asking an enhanced price from him to whom he seeks to sell the property; but he must not be guilty of any conduct which amounts to unfair concealment on his part of the real facts of the case, which ought in common fairness to be disclosed to a person seeking to purchase or entering into a treaty with him for that purpose. As regards partners there is no doubt that one partner is bound to exercise uberrima fides with regard to any transactions in which the partners may be engaged in common. There is another class of cases well known in courts of equity which has some bearing upon the case before us, and that is where a person, acting as agent for a purchaser, receives a gratuity of some description from the intending vendor. In that case, again, the courts interfere, and say that a negotiation carried on between the agent for the purchaser, and the vendor as principal, in which the agent for the purchaser receives benefits or advantages of any kind from the intending vendor, is one which can be impeached, and which would be set aside in a court of equity.

We have the company quite right, as appears to me, down to Oct. 23 with regard to the question of laches. The bill was filed on Dec. 24. I confess, that being so, considering the magnitude of the case and the difficulties there would be in the way of any rapid progress, the quantity of information that had to be obtained, and the action of the [shareholders] committee in endeavouring to bring about a compromise, I do not see in that interval between Oct. 23 and Dec. 24, filled up as it was in a great degree, although not wholly, with communications with Baron Erlanger, that amount of laches which would induce your Lordships to say that the right which, as every court and every judge before whom the case has come agrees, once clearly existed, was waived and lost in consequence of the neglect of the company to take steps in due time to free themselves from the contract. No doubt the case of a mine is one which we must look into with very great accuracy; and if once we saw the slightest appearance of malafides, if we saw the slightest indication of wavering and indecision whether or not the remedy should be taken until they saw how the thing would turn out, that might be a very different matter. But although it is true that things were prosperous in February, that was not brought home to the minds of all the shareholders who were not present at that meeting. At the next meeting the appointment takes place of the committee of shareholders, obviously for the purpose of seeing what can be done to free themselves from the contract. Negotiations take place immediately after that, because the committee were recommended to see what could be done by negotiation; and after the failure of the negotiation there is no long or unreasonable time until the filing of the bill. I am satisfied that in this case the appeal ought to fail, and should be dismissed with costs.

LORD O'HAGAN – The original purchase of the island of Sombrero was perfectly legitimate, and it was not less so because the object of the purchasers was to sell it again, and to sell it by forming a company which might afford them a profit on the transaction. The law permitted them to take that course and provided the machinery by which the transfer of their interests

might be equitably and beneficially effected for themselves and those with whom they meant to deal. But the privilege given to them for promoting such a company for such an object involved obligations of a very serious kind. It required, in its exercise, the utmost good faith, the completest truthfulness, and a careful regard to the protection of the future shareholders. The power to nominate a directorate is manifestly capable of great abuse, with very evil consequences to multitudes of people who have little capacity to guard themselves. It should be watched with jealousy, and restrained from employment in such a way as to mislead the ignorant, the unwise, or the unwary. In all such cases the directorate nominated by the promoters should stand between them and the public, with such independence or intelligence that they may be expected to deal fairly, impartially, and with adequate knowledge, in the affairs submitted to their control. If they have not those qualities, they are unworthy of trust; they are the betrayers and not the guardians of the company they govern, and their acts should not receive the sanction of a court of justice.

For reasons given by my noble and learned friends, I think that the promoters in this case failed to remember the exigencies of their fiduciary position when they appointed directors who were in no way independent of themselves, and who did not sustain the interests of the company with ordinary care and intelligence. he majority seem to me to have represented simply the great financier to whom they owed their appointments. They were not independent directors dealing for the shareholders, with a single regard to their security and advantage. The value of the island was judicially ascertained to be £55,000; and a few days after, circumstances remaining wholly unchanged, a contract for the sale of it at £110,000 was ratified by three of the five directors, two of them being Mr. Evans and Admiral Macdonald, assisted by their solicitor, who was a member of the syndicate. Apparently, there was no inquiry as to the enormous advance in the price beyond that which the Vice-Chancellor had accepted, no consideration of the state of the property, and no intelligent estimate of its capabilities and prospects. If the directors were nominated merely to ratify any terms the promoters might dictate, they discharged their functions; if it was their duty, as it certainly was, to protect the shareholders, they never seem to have thought of doing it. Their conduct was precisely that which might have been anticipated from the character of their selection, and taking that conduct and character together, I concur in the unanimous opinion of your Lordships that such a transaction cannot be allowed to stand.

The promoters who so forgot their duty to the company they formed as to give it a directorate without independence of position, or vigilance and caution in caring for its interests, which were accordingly subordinated to their own, misused their power, and must take the consequences. This does not necessarily imply the imputation of evil purpose or conscious fraud, and I make no such inputation. The fiduciary obligation may be violated, though there may be no intention to do injustice. If the protection proper and needful for a person standing at disadvantage in relation to his guardian, or his solicitor, or a company so largely in the power of the promoters, be withheld, the guardian, the solicitor, or the promoter cannot sustain a transaction equitably invalidated by the want of it, merely because he is not impeachable with indirect or improper motives.

If for any of the reasons which have been given the purchase would have been set aside by a court of equity if a bill had been filed immediately after it was made, the remaining

question is whether the respondents by their laches or acquiescence have deprived themselves of a right to a rescission? I cannot think so. No doubt there is force in the arguments which have been urged as to the peculiar nature of the property, the shortness of the lease, the deterioration of the value, and the consequent difficulty of replacing the parties on either side in status quo ante. But, notwithstanding, I have seen no sufficient reason to hold that the lapse of fourteen months before the suit was instituted, under the peculiar circumstances of the case, disentitled the respondents to seek relief. I am of opinion that the decree should be affirmed and the appeal dismissed with costs.

LORD SELBORNE - By such an adoption of such a contract the company could not be bound in equity if, when the material facts became known to the shareholders, they sought to be relieved from it within a reasonable time; nor could the nature of the property (a lease of minerals for years, of speculative value) make any difference in this respect. It was the act of the vendors to put their property, being of that character, in such a position; and, unless some equity arises against the company from some conduct or omission of their own, the vendors must take the consequences of that act. The company were put into possession of the property as a going concern; they took over the manager, and all the other agents whom they found upon it, and did not alter or interfere with the course of management until they found that the manager was not doing his duty properly, when they promptly did what was right, and appointed a new, and a fit, person to succeed him. There has, therefore, been nothing done, or left undone, to the injury of the property, since it came into the company's hands, which can now stand in the way of the company's right to relief, unless they have precluded themselves from it by acquiescence, and the relief given by the decree is such as, under these circumstances, is proper and usual, and is granted upon the usual equitable conditions.

With respect to the question of acquiescence, HIS LORDSHIP said, two things were generally necessary - first, that there should have been sufficient knowledge of the facts on which the equity depended, and, secondly (when a contract was sought to be rescinded), that there should have been substantial freedom of choice and action, independent of the original influence under which the voidable contract was made. On consideration of the evidence he could not impute any acquiescence, which would make it inequitable to rescind the contract. The decision of the Court of Appeal in Chancery was correct, and ought to be affirmed.

LORD GORDON – I have no doubt that the syndicate, which was formed for the purchase of the interest of the Old Sombrero Co. in the island in question, and by which the rights of the old company were purchased, acquired the property for its own behalf, and not in trust for the company which was afterwards formed. The property when purchased belonged absolutely to the members of the syndicate, who were entitled to deal with it in any way they thought proper. Having acquired the property, they resolved to form a company for the working of the produce of the island, and to make over their purchase to that company. They became promoters of the company, and prepared the necessary documents for its formation, and issued a prospectus to the public with the view of inducing the public to take up its shares. In doing this the syndicate changed the position it originally held, and put itself in a fiduciary relation to the company which it was engaged in forming. It thus became incumbent on the

promoters, not only to make a full disclosure of the position they as owners of the property which they proposed to sell to the company held in regard to that property, but also to make arrangements, by the appointment of competent officials and otherwise, for enabling the company to form an independent judgment as to the propriety of purchasing the property of the promoter, and of the value of that property, and the price to be paid for it. I agree with your Lordships in thinking that the promoters failed in their duty in this respect, and that the company was not put in a position for forming an intelligent and independent judgment as to the contract between the promoters and the company, and that if the contract had been challenged by the company in proper time it might have been set aside.

The only questions of difficulty in this case are whether the contract has been challenged in due time or whether there has been such laches on the part of the company so as to prevent their now demanding the rescission of the contract, and whether the terms on which the Court of Appeal has set aside the contract are fair and equitable. After very careful consideration, I am of opinion that the company has not lost its right of challenge. The onus lay on the appellants of showing that there had been such laches on the part of the company as to deprive it of the right to set aside the contract. I think that the appellants have failed to show that there has been such laches on the part of the company. Therefore, I am of opinion that the judgment appealed against is right, and should be affirmed.

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MEMORANDUM OF ASSOCIATION

DOCTRINE OF ULTRA VIRES

Ashbury Railway Carriage and Iron Company Limited v. *Riche*

[1874-80] All E.R. Rep. 2219 (HL)

This was a proceeding in error from a judgment of the Court of Exchequer Chamber, affirming a judgment of the Court of Exchequer upon a special case stated by an arbitrator in an action brought by the respondent under the following circumstances:–

The company was incorporated under the Companies Act 1862. Clause 3 of the memorandum of association was as follows:

> "3. The objects for which the company is established are, to make, or sell, or lend on hire railway carriages and waggons, and all kinds of railway plant, fittings, machinery, and rolling stock; to carry on the business of mechanical engineers and general contractors; to purchase, lease, work, and sell mines, minerals, land and buildings; to purchase and sell, as merchants, timber, coal, metals or other materials, and to buy and sell any such materials on commission or as agents."

By the articles of association the business of the company might be extended to objects beyond those expressed or implied in the memorandum of association by a special resolution, but no such resolution was ever passed. Riche had obtained a concession from the Belgian Government to make a railway from Antwerp to Tournay, and the directors of the company entered into a contract with him, the purport of which was to take over the concession, to establish a *société anonyme*, to raise money for constructing the railway, to pay towards the funds of the *société*, and to take bonds or shares in exchange and to give to Riche the business of supplying the iron and the rolling stock. Money difficulties arose, and the shareholders, becoming aware of the contract, appointed a committee of investigation, which reported that it was *ultra vires* altogether. The shareholders, however, permitted the accounts to pass, amicable arrangements were recommended, and a deed, dated 24 December 1867, was executed, by which the directors were, as between themselves and the shareholders, compelled to take upon themselves the burden of the contract with Riche, the company consenting to allow their name to be used in legal proceedings. Afterwards Riche, finding that the contract was not duly performed commenced this action, insisting that whatever arrangements might have been made between the directors and the shareholders, the company was liable to him. The Court of Exchequer held that the contract was *ultra vires*, but Martin and Channel, BB., thought that it could be, and had been ratified by the shareholders, and gave judgment for the plaintiff, Bramwell, B., dissenting. Error was brought, and the Court of Exchequer Chamber was equally divided, Blackburn Brett, and Grove, JJ., being of the same opinion as the majority of the Court of Exchequer, Keating, Archibald, and Quain, JJ., taking the opposite view. The judgment accordingly stood affirmed, and error was brought to the House of Lords.

THE LORD CHANCELLOR (CAIRNS) – The history and progress of the action out of which the present appeal arises, is not, I must say, creditable to our legal system. There was not in the case any fact in dispute, and the only questions which arose were questions of law, or questions perhaps as to the proper inference to be drawn from facts as to which there was no dispute.

The action was commenced in the month of May, 1868. The litigation appears to have been active and continuing, and yet seven years have been consumed, and the result up to the present time is this; that, in the Court of Exchequer, two out of three Judges were of opinion that the plaintiff should have judgment; and when the case came before the Exchequer Chamber it was heard before six Judges, three of whom were of opinion that the plaintiff was entitled to judgment, the other three thinking the defendant was entitled to judgment. The result, therefore, was that the judgment of the Court of Exchequer was affirmed. But for this difference of opinion amongst the learned Judges, I should have said that the real questions of law which arise in the case, questions which appears to me to be sufficient altogether to dispose of the case, were of an extremely simple character.

The action was brought by the plaintiffs, who are contractors in Belgium, to recover damages for the breach of an agreement entered into between the plaintiff and the appellants, the Ashbury Railway Carriage and Iron Company, limited. This company was established under the Joint-Stock Company's Act of 1862, and I think it will be therefore necessary to consider, with some minuteness, some of the leading provisions of that Act of Parliament. But in the first place it may be convenient to ascertain the purposes for which this company was formed, and also the nature of the contract for breach of which the action was brought. The purposes for which a company established under the Act of 1862 is formed, are always to be looked for in the memorandum of association of the company. The memorandum of association of this Ashbury Railway Carriage and Iron Company, limited, declares that it was formed for these objects. Part of the argument at your Lordship's bar was as to the meaning of two of the words used in this part of the agreement, the words "general contractors." As it appears to me, upon all ordinary principles of construction, those words must be referred to the part of the sentence which immediately precedes them. The sentence which I have read is divided into four classes of words. First, the selling, or lending railway carriages, waggons, and all kinds of railway plant, fittings, machinery, and rolling stock. That is an object *sui generis* and complete in the specification which I have read. Secondly, to carry on the business of mechanical engineers and general contractors. That, again, is the specification of an object complete in itself, and according to the principles of construction, the term "general contractors" would be referred to that which goes immediately before, and would indicate the making generally of contracts connected with the business of mechanical engineers, such contracts as mechanical engineers are in the habit of making and are in their business required, or find it convenient to make for the purpose of carrying on their business. The third is to make purchase, lease, work and sell mines, minerals, land, and buildings. That is an object pointing to the working and acquiring of mineral property, and the generality of the two last words "land and buildings," is limited by the purpose for which land and buildings are to be acquired. "Leasing, working and selling of mines and minerals." The fourth head is purchasing and selling timber, coal, or metals, or other materials; buying and selling any such

materials on commission as agents. That requires no commentary. If the term "general contractors" is not to be interpreted as I have stated, the consequence would be this, that it would stand absolutely without any limit of any kind. It would authorize the making, therefore, of contracts of any and every description, and the memorandum in place of specifying the particular kind of business, would virtually point to the carrying on of business of any kind whatsoever, and would therefore be altogether unmeaning.

That being the object for which the company professes, by the memorandum of association, to be incorporated, I now turn to examine the contract upon which the present action is brought. I may relieve your Lordships from any lengthened exposition of the nature of that contract by referring you to the description given of it by Bramwell, B., in the Court of Exchequer, which appears to me accurately to describe the general nature of the agreement. Bramwell, B., states this: "The substance of those contracts," that is the contract upon which the action is brought, and two other contracts which are inseparably connected with them – "the substance of those contracts was this, Gillon and Poeters Baertson had obtained a right to make a railway in Belgium. This right the defendants' directors supposed to be valuable to its owners. That is to say the line could be constructed for such a certain sum, and a *société anonyme* could be constituted, with shareholders to take its shares to such an amount as would give a large sum over the cost of construction. The benefit of this the directors wished to obtain for the defendant company, and to do so they purchased the concession. This was their main object. But the plaintiff had a contract with the concessionaires to construct the line, and to accomplish the object of the directors it was necessary or desirable, or they thought it was, that they should agree with the plaintiff that they, the defendant company, would constitute a *société anonyme*, and, as the plaintiff went on with the work, that they would pay into the hands of the *société anonyme* proportionate funds. The directors accordingly entered into two contracts in the name of the defendant company; one with the concessionaires to purchase the concession; the other with the plaintiff to furnish the *sociétié anonyme* with funds, the latter being auxillary to the former; and they paid the concessionnaires £26,000, part of the price. Now whatever may be the meaning of "carrying on the business of mechanical engineers and general contractors," to my mind it clearly does not include the making of either of these contracts. It could only do so by holding that the words 'general contractors' authorized generally the making of any contract, and this they certainly do not do."

I agree entirely both with the description given by Bramwell, B., of the nature of the contract upon which the present action is brought, and with the conclusion at which he arrives, that a contract of this kind was not within the memorandum of association. In point of fact it was not a contract in which, as the memorandum of association implies, the limited company were to be employed; they were the employers. They purchased the concession of a railway, an object not at all within the memorandum of association, and having purchased that they employed, or they contracted to pay as a person employed, the plaintiff in the present action. That was reversing entirely the old hypothesis of the memorandum of association, and was the making of a contract foreign to, and not included within its compass. Now those being the results of the documents to which I have referred, I will ask your Lordships to consider the effect of the Joint Stock Companies Act of 1862 upon this state of things; and

here I cannot but regret that in the Court of Exchequer the accurate and precise bearing of that Act upon the present case appears to me to have been entirely overlooked or misapprehended, and in the Court of Exchequer Chamber the weight which was given to the provisions of the Act appears to me to have entirely fallen short of that which ought to have been given to it. The Act of Parliament to which I am referring is the Act which put upon its present footing the regulation of joint stock companies, and more especially of those joint stock companies who were to be authorized to trade with a limit to their liability. The objects of the provision under which that system of limiting a liability was incorporated were provisions not merely for the benefit of the shareholders for the time being of the company, but were also intended to provide for the interests of two other very important bodies, in the first place those who might become shareholders in succession to the shareholders for the time being; and secondly the outside public, and more particularly those who might be creditors of companies of this kind. I shall now refer to some of the clauses of that Act, and as I do so I would observe that there is a very marked and entire difference between the two documents which form the title deeds of companies of this description, I mean the memorandum of association on the one hand and the articles of association on the other. With regard to the memorandum, as has often been pointed out, although it appears to have been somewhat overlooked in the present case, the memorandum of association is, as it were, the charter and the limitation of the powers of any company established under the Act. With regard to the articles of association, these play a part subsidiary to the memorandum. They accept the memorandum as the charter of incorporation of the company, and proceed to define the duties, rights, and powers of the governing body as between themselves and the company at large, and the mode and form in which the business of the company is to be carried on, and in which changes in the internal regulations of the company must from time to time be made. With regard, therefore, to the memorandum of association, if you find anything which goes beyond it, or is not warranted by it, the question will arise whether that which is done is *intra vires* not of the directors of the company, but of the company itself. With regard to the articles of association, if you find anything which, still keeping within the memorandum is a violation of, or is in excess of the articles, the question will arise whether that is anything more than an act *extra vires* of the directors, but *intra vires* of the company. Now the clause of the Act to which it is necessary to refer in the first place is the 6th clause. This is the first section which speaks of the incorporation of company, but your Lordships will observe that it does not speak of that incorporation as the creation of a corporation with inherent common law rights, such rights as are by the common law possessed by every corporation, without any other limit than would, by the common law be assigned; but it speaks of a company being incorporated with reference to a memorandum of association, and you are referred thereby to the provisions which subsequently are to be found on the subject of that memorandum. The next clause which is material is the 8th. Thereby the memorandum which the persons are to sign as the preliminary to the incorporation of the company must state the objects for which the proposed company is to be established, and the company is to come into existence for those objects alone. Then the 11th section provides "The memorandum of association shall bear the same stamp as if it were a deed." Your Lordships will observe, therefore, that it is to be a covenant in which every member of the company is to covenant that he will observe the conditions of the memorandum, one of which is that the objects for which the company is established are

those mentioned in the memorandum, and that he will not only observe that, but will observe it subject to the provisions of this Act. Well, but the very next provision in the Act is that contained in the 12th section. The covenant, therefore, is not merely that every member will observe the conditions upon which the company is established, but that no change shall be made by the company in those conditions; and if there is a covenant that no change shall be made in the objects for which the company is established, I apprehend that that includes an engagement that no object shall be pursued by the company or attempted to be obtained by the company in practice, except the object which is mentioned in the memorandum of association. Now, if that is so, if that is the condition upon which the corporation is established, it is, I apprehend, a mode of incorporation which contains in it both that which is affirmative and that which is negative. It states affirmatively the ambit and extent of vitality and power which by law is given to the incorporation, and it states, if it were necessary to state, negatively, that nothing shall be done beyond the ambit, and that no attempt shall be made to use the corporate life for any other purpose than that which is so specified. Now, with regard to the articles of association, I will ask your Lordships to observe how completely the character of the legislation is altered. The 14th section deals with those articles. It provides that the body of shareholders are to be masters of the regulations which, always keeping within the outside limit allowed by law, they may deem expedient for the internal management of the company. In connexion with that section must be taken the 50th section of the Act. Of the internal regulations of the company, therefore, the company are absolute masters; and, provided they pursue the course marked out in the Act, holding a general meeting and obtaining the consent of the company, they may alter those regulations from time to time. But all must be done subject to the conditions contained in the memorandum of association. That is to override and overrule any provisions of the articles which may be at variance with it. The memorandum of association is as it were the area beyond which the action of the company cannot go, but inside that area they may make such regulations for their own government as they think fit. That reference to the Act will enable me to dispose of a provision in the articles of association in the present case which was hardly dwelt upon in argument, but which I refer to that it may not be supposed to have been overlooked. I refer to No. 4 of the articles of association of this company, which is in these words: "An extension of the company's business beyond or for other than the objects or purposes expressed or implied in the memorandum of association, shall take place only in pursuance of a special resolution." In point of fact no resolution for the extension of the business of the company was come to in this case; but even if it had been come to it would have been nugatory and inefficacious. There was in this 4th article an attempt to do the very thing which by the Act of Parliament was prohibited to be done, to claim and arrogate to the company a power, under the guise of internal regulation, to go beyond the objects or purposes expressed or implied in the memorandum. Now bearing in mind the difference which I thus take the liberty of pointing out between the memorandum and the articles, we arrive at once at all which appears to me to be necessary for the purpose of deciding this case. I have used the expression *extra vires* and *intra vires*. I prefer that expression very much to one which occasionally has been used in the judgments in the present case – the expression illegality. In a case such as your Lordships have now to deal with, it is not a question whether the contract sued upon involves that which is *malum prohibitum* or *malum in se*, or in a contract contrary to public policy, and illegal in

that sense. I assume the contract in itself to be perfectly legal; to have nothing in it obnoxious to any of the powers involved in the expressions which I have used. The question is not the illegality of the contract, but the competency and power of the company to make the contract. I am of opinion that this contract was, as I have said, entirely beyond the objects of the memorandum of association. If so it was thereby placed beyond the powers of the company to make the contract. If so it is not a question whether the contract ever was ratified or not ratified. If it was a contract void at its beginning it was void for this reason – because the company could not make the contract. If every shareholder of the company had been in this room, and every shareholder of the company had said, "That is contract which we desire to make, which we authorize the directors to make, to which we sanction the placing the seal of the company," the case would not have stood in any different position to that in which it stands now. The company would thereby by unanimous assent have been attempting to do the very thing which by the Act they were prohibited from doing. But if the company *ad ante* could not have authorized a contract of this sort being made, how could they subsequently have sanctioned the contract after in point of fact it had been made? Mr. Benjamin endeavoured to contend that when a company had found that something had been done by the directors which ought not to have been done, they might be authorised to make the best they could of a difficulty into which they had thus been led, and therefore might acquire a power to sanction the contract being proceeded with. I am unable to sanction that suggestion. It appears to me it would be perfectly fatal to the whole scheme of legislation to which I have referred, if you were to hold, in the first place, that directors might do that which even the company could not do, and that then the company, finding out what had been done, could sanction subsequently what they could not have authorized antecedently. If this be the point of view of the Act of Parliament, it reconciles, as it appears to me, the opinion of all the judges of the Court of Exchequer Chamber, because I find that Blackburn, J., whose judgment was concurred in by two other judges, says, "I do not entertain any doubt that if on the true construction of the statute creating the corporation, it appears to be the intention of the Legislature, expressed or implied, that the corporation shall not enter into a particular contract, every court, whether of law or equity, is bound to treat a contract entered into contrary to the enactment as illegal, and therefore wholly void, and to hold that a contract wholly void cannot be ratified." That sums up and exhausts the whole case. I am of opinion beyond all doubt on the true construction of the statute of 1862 creating the corporation, that it was the intention of the Legislature, not implied but actually expressed, that the corporation should not enter, having regard to this memorandum of association, into a contract of this description. If so, according to the words of Blackburn, J., every court whether of law or equity, is bound to treat that contract, entered into contrary to the enactment, I will not say as illegal, but as wholly void, and to hold also that a contract wholly void cannot be ratified. That relieves me and if your Lordships agree with me, relieves your Lordships from any question of ratification. I am bound to say that if ratification had to be considered, I have found in this case no evidence which to my mind is at all sufficient to prove ratification, but I desire to say that I do not wish to found my opinion upon any question of ratification. This contract in my judgment could not have been ratified by the unanimous assent of the whole corporation. For these reasons I submit to your Lordships and move that the judgment in the present case should be reversed, and judgment be entered for the defendants.

LORD HATHERLEY – I am of the same opinion. I must confess it appears to me that the case is really reduced to one of a very simple character, and the question amounts merely to this: What is the true construction of the Act of Parliament with reference to the memorandum of association, and the powers conferred upon companies associated upon the limited principle, subject to that memorandum? As regards the first question of fact, namely, whether or not the agreement in question upon which the suit has been actually commenced by Messrs. Riche, be one within the memorandum of association, it appears to me to be scarcely capable of argument. How it could possibly be brought within any of the terms contained in that memorandum, even with the aid of the ingenious arguments that we have heard at the bar, it is very difficult to conceive, because it was admitted by those upon whom the burden was thrown of showing that the memorandum of association would cover it, that the words "general contractors" must have some limit. It could not be contended that under those words the company were at liberty to contract for anything in the world. The expression must be limited, in some degree at least, by the words that precede it. I need say no more with reference to whether or not the contract in question, which is a contract to furnish another company altogether, the *société anonyme* of Brussels, with money, from time to time in order to carry into effect the works of a railway, is to be considered a contract within the scope of the memorandum of association of the Ashbury Company. The only other point in the case independent of the Act of Parliament, is the question of ratification. I confess I concur with the opinion which has already been expressed by your Lordships that there is not anything amounting to confirmation, if it were necessary to decide that point. I do not dwell upon it because I am of opinion that no amount of ratification or confirmation by individual shareholders could give validity to the contract in question. That depends upon the Act of Parliament, which is the real point in the case. When you consider that this Act was passed with the view of enabling persons to carry on business on principles which were up to that time wholly unknown in the general conduct of mercantile affairs in this country, when you consider that the general principle of partnership was that every person entering into any partnership whatsoever thereby subjected, before this description of legislation had been entered upon, the whole of his property, whatever it might be, to the demands of his creditors, it is impossible not to feel that when these legislative enactments, which gave power to depart from that principle upon certain conditions to be expressed in the Act of Parliament by which companies would be framed with that view, came to be made, it was necessary that the public, that is the persons dealing with a limited company, should be protected, as well as the shareholders themselves. Accordingly your Lordships will find throughout the whole of the Act a plain and marked distinction drawn between the interest of the shareholders *inter se*, and the interest which the public have in seeing that the terms of the Act are construed in such a manner as to protect them in dealing with companies of this description. The mode of protection adopted seems to have been this: the Legislature said, you may meet altogether, and form yourselves into a company, but in doing that you must tell all who may be disposed to deal with you the objects for which you have been associated. They will trust to that memorandum of association, and they will see that you have the power of carrying on business in such a manner as it specifies, to be limited, however, by the extent of the shares, that is to say, the money you may contribute for the purpose of carrying on that business. You must state the amount of the capital which you are about to invest in it, and you must

state the objects for which you are associated, so that the person dealing with you will know that they are dealing with persons who can only devote their means to a given class of objects, and who are prohibited from devoting their means to any other purpose. Throughout the Act that purpose is apparent. With regard to the amount of capital, which is one point that I have referred to, the Act did give a special power of variation. But with regard to the memorandum of association, that is carefully protected by the 12th section. It is provided that whatever other things you may do in the way of variation, a certain limited power of alteration being given to you, no such power shall you have as to the objects specified in the memorandum of association. That being so, one turns to the views expressed by the learned judges who have decided that the contract which has been entered into in this case is one by which the company have been bound. Turning to the reasons upon which they have based that opinion, one finds them very clearly expressed in the judgment of Blackburn, J. His view appears to be this: True it is that the objects to which the common seal was applied in this case by the corporation may not be such as the directors could justify to their corporators; but then the corporation was called into being, and when the corporation was called into being you had an entity which could act by its common seal, just as any physical entity might act through his contract. Having created that entity you cannot say the contract is void, whatever may be the consequence which may enure to the persons who are affected by the act of the directors in affixing the common seal. Whatever acts they may have to complain of you cannot say that the act is void as against the persons who claim the benefit of that common seal, the power of affixing which you conferred upon them by making them a corporation. Then he cites passages from Lord Coke and Plowden, to show that when once you have given being to such a body as this, you must be taken to have given to it all the consequences of its being called into existence, unless by express negative words you have restricted the operation of the acts of the being you have so created. Now I think when this proposition is applied to the objects of this present Act of Parliament it must be clearly seen, not only that the entity which this corporation called into existence for the purpose of trading with limited liability, has by affirmative words those objects which are specified in the memorandum of association, as the objects for which it was called into being, but also that you find express negative words providing that "save as aforesaid no alterations shall be made in the conditions contained in the memorandum of association." That is a distinct limitation by way of negative of the powers and authorities which you have conferred upon this entity. You say, we confer upon this corporate body the power of acting according to their memorandum, and we also say that that memorandum shall never be changed. I think it is far too nice a refinement to say that that is not equivalent to saying in so many words, the objects of the memorandum are your objects, and no other ever shall or can be your objects. I think that the Legislature had in view distinctly the object of protecting outside dealers and contractors with this limited company from the funds of the company being applied, or from a contract being entered into by the company for any other objects whatever than those mentioned in the memorandum, which the Legislature thought should remain for ever unchanged. It is quite true, as was said in the agreement, that those same gentlemen who signed the memorandum might, the next hour, if they liked, go into another room, and frame a new object of business besides those specified in the memorandum they had already agreed to. But it would be a perfectly new company in that case, and neither as regards their shareholders, nor still more as

regards the general body of the public, have they the power or authority under the Act to combine together, as a corporation with limited liability, to carry on business for any other purpose whatever than that specified in the memorandum of association. Mr. Benjamin, feeling the pressure of the case in reference to the act which has been done, endeavoured to put this before us: *Fieri non debuit, sed factum valet*. He said, suppose I have to concede that the original contract was invalid, still the subsequent arrangements by which the company endeavoured to make the best they could of the difficult situation in which their directors have placed them, might be taken to be valid. It may have been done, not for the purpose of evading the Act of Parliament, but rather the contrary, to bring things back to such a state and condition as the law would allow, and to make the best of what had been the misfortune of the company. I apprehend that no such principle can be adopted as that the directors having committed an unlawful act, and then having taken the proper course, as it appears to me, in proposing, as they did by the instrument of 24 December 1867, to take the whole burden and responsibility upon themselves, the very proper act which they then did could give any validity whatever to that supposed contract. I apprehend that the true construction of that deed is this, that the deed provides that whatever rights the company might have acquired in consequence of the directors dealing with this property, or in consequence of strangers dealing with them, and attempting to take advantage of the contract, knowing that the moneys of the company had been employed in a manner which was *ultra vires*, that those rights should not be enforced. When a stranger has taken money of a company which ought to have been applied in one way, knowing that it ought to be so applied, and has applied it in another way, that money is earmarked for the original purpose, and can be followed as against the stranger, with any advantage that he may have derived in consequence of the improper contract which has been made. That being the case, I should read the instrument as an admission on the part of the company that, repudiating and rejecting altogether the contract, if they had any rights whatever of the description that I have mentioned, they would not exercise them. Perhaps, however, it is unnecessary for me to enter into that point, considering that I hold upon this contract that it was one which no body of shareholders had power to ratify, it being by the 12th section of the Act illegal and void, as being contrary to the purpose for which, and for which only, power and authority was given by the Legislature, any other purpose being, according to my view of the case, expressly and distinctly prohibited by the clauses that I have referred to.

LORD SELBORNE – The action in this case is brought upon a contract not directly or indirectly to execute any works, but to find capital for a foreign railway company in exchange for shares and bonds of that company. Such a contract, in my opinion, was not authorized by the memorandum of association of the Ashbury Company. All your Lordships, and all the judges in the courts below, appear to be so far agreed. But this in my judgment is really decisive of the whole case. I only repeat what Lord Cranworth stated to be settled law in ***Hawkes* v. *Eastern Countries Railway Company*** [1855, 5 H.L. Cas. 331], when I say that a statutory corporation, created by Act of Parliament, for a particular purpose, is limited as to all its powers by the purpose of its incorporation as defined in that Act. The present and all other companies incorporated by virtue of the Companies Act of 1862, appear to me to be statutory corporation within this principle. The memorandum of association is, under that

Act, their fundamental law, and they are incorporated only for the objects and purposes expressed in that memorandum. The object and policy of those provisions of the statute which prescribe the conditions to be expressed in the memorandum, and make these conditions, except in certain points, unalterable, would be liable to be defeated if a contract under the common seal, which on the fact of it transgresses the fundamental law, were not held to be void and *ultra vires* of the company, as well as beyond the power delegated to its directors or administrators. It was so held in the case of the ***East Anglian Railway Company*** [1851, 21 L.J.C.P. 23] and in the other cases upon Railway Acts which were approved by this House in ***Hawke*** case, and I am unable to see any distinction, for this purpose, between statutory corporations under Railway Acts and statutory corporations under the Companies Act of 1862. I cannot agree with the view of the judges who were for affirming the judgment in the Court of Exchequer Chamber. I think that contracts for objects and purposes foreign to, or inconsistent with the memorandum of association are *ultra vires* of the corporation itself. And it seems to me far more accurate to say that the inability of such companies to make such contracts rests on an original limitation and circumscription of their powers by the law and for the purposes of their incorporation, than that it depends upon some express or implied prohibition, making acts unlawful which otherwise they would have had a legal capacity to do. This being so, it necessarily follows that where there could be no mandate there cannot be any ratification, and that the assent of all the shareholders can make no difference when a stranger to the corporation is suing the company itself in its corporate name upon a contract under the common seal. No agreement of shareholders can make that a contract of the corporation which the law says cannot and shall not be so. If, however, this contract could have been susceptible of confirmation or ratification by the universal consent of all the shareholders, I should have been of opinion that there was here no evidence whatever to go to a jury of any such confirmation or ratification. What was relied upon consists entirely of resolutions passed at certain general meetings of the shareholders and a deed executed pursuant to those resolutions. But there is no evidence whatever that they were communicated to any shareholder who was not present at those meetings, by notice, either beforehand or afterwards. The notices under which these meetings were convened contained nothing from which any shareholder could be led to suppose that it was in contemplation to enter into or adopt on the part of the company any contract or arrangement in excess of the ordinary powers of the company, as represented by the shareholders assembled at a duly constituted general meeting. There is no obligation upon any shareholder receiving such notices either to attend the meetings or to make inquiries as to what is proposed to be done at them, in order to protect himself from being bound by acts or contracts *ultra vires* of any general meeting. He will, of course, be bound by all that the general meeting can do as to the matters mentioned in the notices within their powers, but he cannot, in his absence and without his knowledge, be taken to consent that they shall bind him by any resolutions or acts in excess of those powers, whether such acts or resolutions do or do not relate to the particular business for the transaction of which those meetings were called together.

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Cotman v. *Brougham*

[1918-19] All E.R. Rep. 265(HL)

Sub-clause (1) of the objects clause (cl. 3) of the memorandum of association of the E. company, authorised the company to develop certain property abroad. The remaining sub-clauses of cl. 3 set out a variety of objects, including the promotion of other companies and dealing in their shares, and concluded "the objects set forth in any sub-clause of this clause shall not, except when the context expressly so requires, be in any wise limited or restricted by reference to or inference from the terms of any other sub-clause, or by the name of the company. None of such sub-clauses or the object therein specified or the powers thereby conferred shall be deemed subsidiary or auxiliary merely to the objects mentioned in the first sub-clause of this clause, but the company shall have full power to exercise all or any of the powers conferred by any part of this clause in any part of the world, and notwithstanding that the business, undertaking, property, or acts proposed to be transacted, acquired, dealt with, or performed do not fall within the objects of sub-cl. 1." The company underwrote and took up shares in another company the business of which was not connected with the E. company or with the objects set out in cl. 3(1). On a summons in the liquidation of the other company it was contended that this transaction was *ultra vires* the E. company.

***Held*:** as the registrar had accepted the memorandum of the E. company, and granted a certificate of incorporation, the validity of the memorandum could not be challenged, and its memorandum must be construed as it stood, and so the transaction was *ultra vires*.

Per LORD WRENBURY: Before registering a memorandum of association the registrar ought to consider whether the requirements of the Companies Acts have been complied with, and to refuse registration if he conceives that they have not. The memorandum must delimit and identify the field of industry within which the corporate activities are to be confined.

Per LORD ATKINSON and LORD PARKER: For the purpose of determining whether a company's substratum be gone, it may be necessary to distinguish between power and object, and to determine what is the main or paramount object of the company, but this is not necessary where a transaction is impeached as *ultra vires*.

LORD FINLAY, LC. – The Essequibo Rubber and Tobacco Estates, Ltd., is a company which was registered on April 6, 1910. The memorandum of the association is one of a type which unfortunately has become common. The Companies (Consolidation) Act, 1908 requires that the memorandum of association should set out (*inter alia*) "the objects of the company" (s. 3). The memorandum of this company in cl. 3 set out a vast variety of objects and wound up with the following extraordinary provision:

> "(30) The objects set forth in any sub-clause of this clause shall not, except when the context expressly so requires, be in anywise limited or restricted by reference to or inference from the terms of any other sub-clause, or by the name of the company. None of such sub-clauses or the objects therein specified or the powers thereby conferred shall be deemed subsidiary or auxiliary merely to the objects mentioned in the first sub-clause of this clause, but the company shall have full power to exercise all or any of the powers conferred by any part of this clause in any part of the world,

and notwithstanding that the business, undertaking, property, or acts proposed to be transacted, acquired, dealt with, or performed to do not fall within the objects of the first sub-clause of this clause."

WARRINGTON, L.J., expressed some doubt in his judgment in this case whether a memorandum setting out such a profusion of objects was a compliance with the Act, and it is possible that in some future case the question may arise on application for a mandamus if the registrar should refuse registration, taking the ground that the Act requires that the memorandum should be in such a form that the real objects of the company are made intelligible to the public.

In the present case no such question arises. The registrar accepted the memorandum of association and gave a certificate of incorporation, and that certificate is conclusive. Section 17 of the Act enacts that

"A certificate of incorporation given by the registrar in respect of any association shall be conclusive evidence that all the requirements of this Act in respect of registration and of matters precedent and incidental thereto have been complied with, and that the association is a company authorised to be registered and duly registered under this Act."

The question is whether it was *intra vires* of the Essequibo Rubber Company to enter into the transaction which has ended in the company's name being put upon the B list of contributories to another company, the Anglo-Cuban Oil, Bitumen and Asphalt Co., Ltd. The Essequibo company underwrote shares in the Anglo-Cuban company and received an allotment of 17,200 such shares. An order was made for a compulsory liquidation of the Anglo-Cuban company, and it was ordered that the Essequibo company, which is already in liquidation, should be placed on the B list of contributories in respect of £14,046 due upon these shares. An application was made to strike out the name of the Essequibo company from the list of contributories on the ground that the whole transaction was *ultra vires*. NEVILLE, J., refused the application, and he was affirmed by the Court of Appeal. The question depends on the interpretation to be put upon the third clause of the memorandum of association. This clause has thirty heads dealing with a multitude of objects and of powers. It is only necessary to refer to the eighth and twelfth heads of that clause, in addition to the general provision at the end of the clause which I have already quoted:

"(8) To promote, form, issue, and be interested in any company or companies, either in Great Britain, British Guiana, or elsewhere, and take, acquire, hold, transfer, sell, surrender, or otherwise dispose of and deal in shares, stocks, bonds, obligations, debentures, debenture stock, script or securities in or of any such company, and to transfer to any such company any property of this company, and to subsidise or otherwise assist any such company; and in the event of any property sold to such company proving unsatisfactory, to make over to it, gratuitously or otherwise, any other property or rights, either in lien of the property sold or transferred or otherwise...

(12) To buy or otherwise acquire in any way and hold, sell, or deal with or in any stocks, shares, securities, or obligations of any Government, authority, corporation,

or company which may be considered capable of being profitably held or dealt in or with by the company."

I agree with both courts below in thinking that it is impossible to say that the acquisition of these powers was *ultra vires* of the Essequibo company.

It is well worthy of consideration whether, if it should appear that the law as it stands is not sufficient to cope with such abuses as are exemplified in the memorandum now in consideration, the Companies Act should not be amended so as to bring the practice into conformity with what must have been the intention of the framers of the Act. But the only question before us now is the construction of the memorandum as it stands, and in my opinion this appeal must be dismissed with costs.

LORD PARKER (read by LORD ATKINSON) – I agree. It may well be that the memorandum of association in the present case is not framed on the lines contemplated by the Companies (Consolidation) Act, 1908. This point would no doubt have been open to argument on proceedings for a mandamus had the registrar refused to accept it. Possibly also it might have been raised in proceedings on behalf of the Crown to cancel the company's certificate of incorporation. It cannot, however, be raised in these proceedings because the seventeenth section of the Act makes the certificate of incorporation conclusive evidence that (*inter alia*) the provisions of S. 3 as to stating the objects of the company in its memorandum of association have been duly complied with. The only point, therefore, open to your Lordship's House is the true construction of such memorandum, and on this point I find myself in such complete agreement with the Lord Chancellor that I have little to add. Clause 3(8) and (12) of the memorandum are in their terms amply wide enough to cover the transaction in question, and the concluding words of sub-cl. (30) were clearly introduced to preclude the operation of these (among other) sub-clauses being cut down by considerations.

Counsel for the liquidator suggested that, in considering whether a particular transaction was or was not *ultra vires* a company, regard ought to be had to the question whether at the date of the transaction the company could have been wound-up on the ground that its substratum had failed. Upon consideration I cannot accept this suggestion. The question whether or not a company can be wound-up for failure of substratum is a question of equity between a company and its shareholders. The question whether or not a transaction is *ultra vires* is a question of law between the company and a third party. The truth is that the statement of a company's objects in its memorandum is intended to serve a double purpose. In the first place, it gives protection to subscribers, who learn from it the purposes to which their money can be applied. In the second place, it gives protection to persons who deal with the company and who can infer from it the extent of the company's powers. The narrower the objects expressed in the memorandum the less is the subscribers' risk, but the wider such objects the greater is the security of those who transact business with the company. Moreover, experience soon showed that persons who transact business with companies do not like having to depend on inference when the validity of a proposed transaction is in question. Even a power to borrow money could not always be safely inferred, much less such a power as that of underwriting shares in another company. Thus arose the practice of specifying powers as objects, a practice rendered possible by the fact that there is not statutory limit on

the number of objects which may be specified. But even thus, a person proposing to deal with a company could not be absolutely safe, for powers specified as objects might be read as ancillary to and exercisable only for the purpose of attaining what might be held to be the company's main or paramount object and on this construction no one could be quite certain whether the court would not hold any proposed transaction to be *ultra vires*. At any rate, all the surrounding circumstances would require investigation. Fresh clauses were framed to meet this difficulty, and the result is the modern memorandum of association with its multifarious list of objects and powers specified as objects, and its clauses designed to prevent any specified object being read as ancillary to some other object. For the purpose of determining whether a company's substratum be gone, it may be necessary to distinguish between power and object, and to determine what is the main or paramount object of the company, but I do not think this is necessary where a transaction is impeached as *ultra vires.* A person who deals with a company is entitled to assume that a company can do everything which it is expressly authorised to do by its memorandum of association, and need not investigate the equities between the company and its shareholders.

The only other point which I need mention is the company's name. In construing a memorandum of association, the name of the company, being part of the memorandum can, of course, be considered; but where the operative part of the memorandum is clear and unambiguous, I do not think its obvious meaning ought to be cut down or enlarged by reference to the name of the company. It should be remembered that the name is susceptible of alteration, and it would be impossible to hold that such alteration could diminish or enlarge company's powers. On the other hand the name may be very material if it be necessary to consider what is the company's main or paramount object in order to see whether its substratum is gone. I think the appeal should be dismissed with costs.

LORD WRENBURY – On April 16, 1910, the Essequibo Rubber and Tobacco Estates, Ltd. were incorporated by registration under the Companies (Consolidation) Act, 1908. To obtain the advantage of that incorporation, the law required that "the memorandum must state...the objects of the company": [S. 3(1)(iii)]. There is some guidance furnished by the Act as to the meaning of these words. There are other matters which the Act requires to be stated in the memorandum. Section 7 and S. 45 speak of all collectively as "conditions contained" in the memorandum of association; S. 41 as "conditions of its memorandum." Section 9 speaks of the "provisions of its memorandum" with respect to the objects. Section 9 shows that the Act contemplates that the company will as a consequence of "the provisions of its memorandum" have what the Act calls "its business" and will have a "main purpose." Section 9(e) speaks of the "objects specified in the memorandum." The meaning of the Act in this respect is not without authority, which, at any rate, is some guidance. One ground for winding up is that the court is of opinion that it is just and equitable that the company should be wound-up: S. 129(vi). ***Re German Date Coffee Co.*** [(1882) 20 Ch. D. 169] is the leading authority for the proposition that when that which is called the substratum of the company is gone, a winding-up order may be made under S. 129(vi). The substratum is gone when the "main purpose" has become impossible. This class of cases recognises the existence of a "main purpose" in a memorandum which names a host of acts in the clause which has to state the objects.

I cannot doubt that, when the Act says that the memorandum must "state the objects", the meaning that it must specify the objects; that it must delimit and identify the objects in such plain and unambiguous manner that the reader can identify the field of industry within which the corporate activities are to be confined. The purpose, I apprehend, is twofold. The first is that the intending corporation who contemplates the investment of his capital shall know within what field it is to be put at risk. The second is that anyone who shall deal with the company shall know without reasonable doubt whether the contractual relation into which he contemplates entering with the company is one relating to a matter within its corporate objects. The objects of the company and the powers of the company to be exercised in effecting the objects are different things. Powers are not required to be and ought not to be specified in the memorandum. The Act intended that the company, if it be a trading company, should by its memorandum define the trade, not that it should specify the various acts which it should be within the power of the company to do in carrying on the trade. The third schedule of the Act contains model forms of memoranda of association. These ought to be followed. Section 118 enacts that those forms, "or forms as near thereto as circumstances admit", shall be used in all matters to which those forms refer.

There has grown up a pernicious practice of registering memoranda of association which under the clause relating to objects contain paragraph after paragraph not specifying or delimiting the proposed trade or purpose, but confusing power with purpose and indicating every class of act which the corporation is to have power to do. The practice is not one of recent growth. It was in active operation when I was a junior at the Bar. After a vain struggle I had to yield to it, contrary to my own convictions. It has arrived now at a point at which the fact is that the function of the memorandum is taken to be, not to specify, not to disclose, but to bury beneath a mass of words the real object or objects of the company, with the intent that every conceivable form of activity shall be found included somewhere within its terms. The present is the very worst case of the kind that I have seen. Such a memorandum is not, I think, a compliance with the Act.

The Act throws on the registrar a great responsibility when it provides, as it does, that his certificate of incorporation "shall be conclusive evidence that all the requirements of this Act in respect of registration and of matters precedent and incidental thereto have been complied with." Before registering a memorandum of association the registrar ought to consider whether the requirements of the Act have been complied with and to refuse registration if he conceives that they have not, bearing in mind that if he does not take that course he may put the court in the position in which your Lordships find yourselves in the present case - a position in which it must assume that all requirements in respect of matters precedent and incidental to registration have been complied with, and confine yourselves to the construction of the document. I shall take care that the committee which is now sitting to inquire as to amendments desirable in the law relating to joint stock companies looks into this question and considers whether amendment is desirable both to strengthen the requirements as to definition of objects and to control in some proper way the finality of the registrar's certificate.

I turn to consider the transaction in question in this case and to see whether it falls within the company's objects upon a true construction of the memorandum of association, assuming, as I am bound to do, that this is a valid instrument. The transaction was as follows. A

company, called the Anglo-Cuban Oil, Bitumen and Asphalt Co., Ltd., was in November, 1910, being promoted by a company called the London and Mexico Exploitation Co., Ltd. The Essequibo company, in November, 1910, sub-underwrote 20,000 shares of 10s. each in the Anglo-Cuban company for a commission of £600 in cash and £5,000 in cash or shares upon one Chansay, who was the promoter undertaking to purchase at par on or before November 30, 1911, any shares which the Essequibo company might have to take up. The Essequibo company had to take up 17,200 shares. On November 29, 1910, they applied for that number, and they were allotted to them. On September 6, 1912, they transferred the shares to the London and Mexican company. On November 12, 1912, an order was made to wind-up the Anglo-Cuban company. The Essequibo company have been put upon the B list of contributories. They, by their liquidator (for they also are in liquidation), applied to vary the B list by excluding their name therefrom. The ground of that application was that the transaction was *ultra vires* the Essequibo company. The only question open on this appeal is whether upon the construction of the memorandum of association the transaction was *ultra vires*. The construction of the instrument does not admit of reasonable doubt. Clause 3(8) and (12) are in terms so wide that an obligation in a contingent event to take up shares falls within them. The language of cl. 3(30) is such that I cannot say that such a transaction was *ultra vires* because it was not ancillary to or connected with or in furtherance of something which I find elsewhere in the company's memorandum to have been "its business." Upon the narrow question upon which alone it is, unfortunately, within the competence of this House to determine, I think the decision below was right. It follows that this appeal must be dismissed with costs.

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In re Jon Beauforte (London) Ltd.

[1953] 1 Ch. 131

A company was authorized by its memorandum of association to carry on the business of costumiers, gown makers, and other activities *ejusdem generis*. The company decided to undertake the business of making veneered panels, which was admittedly *ultra vires*, and for this purpose erected a factory at Briston. The company later went into compulsory liquidation. A number of proofs of debt were lodged, which were rejected by the liquidator on the ground that the contracts to which they related were *ultra vires*. Applications by way of appeal were lodged, as indicated below, by three creditors, none of whom had actual knowledge that the veneer business was *ultra vires*:

1. A firm of builders who constructed the factory had brought an action claiming £2,078 as owing; the company put in a defence that the work had been unlicensed. Later, the company consented to judgment for £2,000 payable in four instalments, the whole of the original debt or the balance thereof remaining due to be payable in the event of default. Default having been made on the first instalment, the creditors signed final judgment for £2,078;

2. A firm supplied veneers to the company valued at £1,011; being unpaid, they issued a specially indorsed writ and recovered judgment summarily in default of defence;

3. A firm sought to prove for a simple contract debt of £107 in respect of coke supplied to the factory; they contended that the fuel might have been used for legitimate purposes. They had received letters from the company on paper headed "Veneered Panel Manufacturers": -

Held, dismissing the applications, (1) that no judgment founded on an *ultra vires* contract could be sustained unless it embodied a decision of the court on the issue of *ultra vires*, or a compromise of that issue; ***Great North-West Central Railway Co.* v. *Charlebois*** [(1899) A.C. 114], considered and explained; (2) that the suppliers of the coke were fixed with clear notice of the purposes of the factory; but (3) that the rejection of the applicants' proofs was without prejudice to any rights which they might have (a) of tracing any of their money or property, or (b) of participating in the distribution of surplus assets, after provision had been made for the claims of proving creditors, costs and expenses.

Applications on appeal from rejection of proofs by liquidator.

The company, Jon Beauforte (London) Ld., was in compulsory liquidation. According to the memorandum of association the objects of the company were:

> "(a) To carry on the business of costumiers, gown, robe, dress and mantle makers, tailors, silk mercers, makers and suppliers of clothing, lingerie, and trimmings of every kind, corset makers, furriers, general drapers, haberdashers, milliners, hosiers, glovers, lace makers and dealers, feather dressers and merchants, utters, boot and shoe makers, dealers in fabrics and materials of all kinds, ribbons, fans, perfumes and flowers (artificial and natural);

(b) To carry on any other trade or business whatsoever which can, in the opinion of the board of directors, be advantageously carried on by the company in connexion with or as ancillary to any of the above businesses or the general business of the company; and

(c) To do all such other things as are incidental or conducive to the above objects or any of them."

Towards the end of 1949 the company decided to undertake the business of manufacturing veneered panels, which was admittedly *ultra vires*, and accordingly entered into an oral contract with Grainger Smith & Co. (Builders) Ld. (admittedly *ultra vires*) for the construction of a factory on the Bedminster Trading Estate near Bristol on a "cost plus" basis, which amounted to £2,078 9s. 3d. On September 20, 1950, the builders sued the company for that amount. The action was transferred to an official referee, and leave to defend was given. The defence was that the work was not licensed. On May 30, 1951, an order was made by consent that all proceedings be stayed and that the company should pay £2,000 in four instalments and that, if the company made default, the builders might sign judgment for the sum of £2,078 9s. 3d., or for the balance thereof then remaining due. The company made default on the first instalment, and on August 9,1951, the builders signed judgment for £2,078 9s. 3d. The earlier consent judgment was in the nature of a compromise, but was arrived at on the footing that the contract was *intra vires*. The builders lodged a proof for £2,078 9s. 3d., which the liquidator rejected.

John Wright & Sons (Veneers) Ld. supplied the company with veneers, and sued for the price, namely, £1,011 2s. 10d. The company did not defend the action or raise the issue of *ultra vires*, and the suppliers obtained leave to sign judgment under Order 14, r. 1, for that sum and costs. The purchase of the veneers was admittedly *ultra vires*. The liquidator rejected the supplier's proof.

On May 17, 1950, the company on paper headed "Veneered Panel Manufacturers; Plywood panels veneered in all woods for interior decoration and furniture, wood block, strip and parquet flooring", entered into correspondence with Lowell Baldwin Ld. which led to a supply of coke. The liquidator rejected a proof for the unpaid price.

It was conceded that the applicants had constructive knowledge of the company's memorandum, and that they had no actual knowledge that their contracts were *ultra vires* the company.

ROXBURGH, J. - I have before me three appeals against these rejections. As regards the last, the argument is that the company needed fuel for its legitimate business, and that the fuel merchant cannot be prejudiced by its misapplication. I need not consider what the position might have been if the fuel merchant had not had clear notice that the business, which the company was carrying on and for which the fuel was required, was that of veneered panel manufacturers. The correspondence shows that they had notice of that, and as they had constructive notice of the contents of the memorandum of association, they had notice that the transaction was *ultra vires* the company. Their proof was rightly rejected, although they and the other two claimants may have other rights arising out of these *ultra vires* transactions.

The other two cases depend upon whether the claimants can pray their judgments in aid; for the transactions out of which they arose are admittedly *ultra vires*.

There seems to be but one authority upon the efficacy of a judgment obtained upon an *ultra vires* contract. It is the decision of the Privy Council in ***Great North-West Central Railway Co.*** **v.** ***Charlebois*** [(1889) AC 114]. On September 9, 1891, the company sued Charlebois for breach of an *ultra vires* contract, and two days afterwards Charlebois sued the company to recover the balance due and for a lien. The question of *ultra vires* was not raised. By consent there was judgment against the company for a large sum and a declaration of lien. The Chancellor of Ontario had said in the court of first instance: "It follows that, if the act is beyond the power of the company to do or ratify, no judgment obtained by the consent of the company treating it as authorized can remove its invalidity, for the virtue of such judgment rests merely on the agreement of the parties, and the incapacity to do the act involves the incapacity to consent that it be treated as valid." The majority of the Supreme Court took a different view. King J., delivering that judgment said: "But now we come to a wholly different question. Charlebois is not suing upon the contract. That has become merged in the judgment rendered upon it, and the present proceedings are to set aside that judgment or to restrain its enforcement. The learned chancellor was of opinion that the judgment has no greater validity than the contract, because it was determined by consent, and the company could not validly give a consent to treat as valid what was *ultra vires*.

But their Lordships of the Privy Council disagreed with them, saying:

> "But the difficulty is to reconcile an opinion that the contract is *ultra vires* with an opinion that a judgment obtained as this was is a binding judgment. The authorities referred to by the Supreme Court do not relate to contracts *ultra vires*. It is quite clear that a company cannot do what is beyond its legal powers by simply going into courts and consenting to a decree which orders that the thing shall be done. If the legality of the act is one of the points substantially in dispute, that may be fair subject of compromise in court like any other disputed matter. But in this case both the parties, plaintiff or defendant in the original action and in the cross-action, were equally insisting on the contract. The president, who appears to have been exercising the powers of the company, had an interest to maintain it, and took a large benefit under the judgment. And as the contract on the face of it is quite regular, and its infirmity depends on extraneous facts which nobody disclosed; there was no reason whatever why the court should not decree that which the parties asked it to decree. Such a judgment cannot be of more validity than the invalid contract on which it was founded."

Now the first difficulty is to decide whether the Privy Council adopted the reasoning of the chancellor with only one reservation (namely, that where *ultra vires* or *intra vires* is a point substantially in dispute, that point may be validly compromised) or whether the Board declined to decide the issue between the chancellor and the Supreme Court in the general terms in which it was raised and confined themselves to holding that where both parties are equally insisting on the contract in the circumstances which existed in that case, a consent order cannot be valid.

I think that the first alternative is to be preferred. “It is quite clear", they said, "that a company cannot do what is beyond its legal powers by simply going into court and consenting.” That proposition seems to me to negative the basis of the judgment of the Supreme Court that a consent judgment raises an estoppel and to involve the adoption of the reasoning of the chancellor, with the one reservation to which I have referred. If that be so, the next question is to draw the line which bounds the principle and the reservation. It seems to me that any compromise made upon the footing that the contract is *intra vires*, and any judgment suffered in an action in which the defence of *ultra vires* is not raised, can be set aside because (applying the principle stated) it is *ultra vires* the company to proceed upon the footing that the contract is *intra vires*, whether by negotiating a compromise on that footing or by submitting to judgment without delivering an appropriate defence. Accordingly, I interpret the judgment of the Privy Council as meaning that in the case of an *ultra vires* contract no judgment founded upon it is inviolable, unless it embodies a decision of a court upon the issue of *ultra vires* or a compromise of that issue and I adopt the reasoning which appears to lead to that conclusion. This decision was cited to Rusell J. in ***York Corporation* v. *Henry Leetham & Sons Ld.,*** [(1924) 1 Ch. 557, 573 where he said: “An *ultra vires* agreement cannot become intra vires by reason of estoppel, lapse of time, ratification, acquiescence, or delay.” Accordingly, the proofs of the builder and the suppliers were rightly rejected.

In view of this conclusion, I need not further explore the arguments which I heard upon the question whether these judgments could be reopened in accordance with the principles applied in bankruptcy and liquidation to judgments generally. But the rejection of the proofs must be accompanied by a reservation of tracing rights which may arise, for the formulation of which I invite the assistance of counsel.

[It was agreed that the following terms should be included in the order:

> “This order is without prejudice to the questions whether the applicants are entitled to trace any money or other property of the applicants are entitled to trace any money or other property of the applicants into any particular asset or the proceeds of sale thereof and to participate in the distribution of any assets remaining in the hands of the respondent liquidator after satisfaction of or provision for the claims of creditors in respect of debts provable in the winding up and all proper costs, charges and expenses in the liquidation.”

It was further agreed that, as the three applicants had been selected to represent other creditors in a quasi-representative capacity, they should be entitled to their costs as between party and party]. Applications dismissed.

* * * * *

Bell Houses, Ltd. v. *City Wall Properties, Ltd.*

[1966] 2 All ER 674

DANCKWERTS, L.J. - This is an appeal from a decision of MOCATTA, J. dated July 5, 1965, in an action brought by the plaintiff company, Bell Houses, Ltd., against the defendants, City Wall Properties, Ltd., to recover a commission or procuration fee of £20,000 under an agreement alleged to have been made between the parties between Feb. 5 and Mar. 9, 1962.

The plaintiff company is a private company limited by shares and its principal business in fact is the development of housing estates. The chairman of the directors, Mr. Randal Mulcaster Bell, controls the company and its administration. The other directors were his wife and a brother of Mr. Bell, but the brother has left the company now. All effective dealings of the company were really done by Mr. Bell, and this was officially authorised by a resolution passed on June 10, 1955, at a meeting of the board of directors whereby it was resolved that the administration of the company generally and with regard to sales be left for the chairman to deal with together with his principal sales agent. The directors had power to delegate in this way by virtue of art. 102 of Table A in Sch. 1 to the Companies Act, 1948, which was incorporated in the company's articles. The method by which the business of the company was transacted was described by Mr. Bell in evidence as being the acquisition of vacant sites for which no planning consent had been obtained, because the land is thus obtained at a cheaper price. The contract of purchase was made subject to planning consent and the company then obtained outline planning consent and proceeded with the development of the site as a housing estate. The practice of the company was to have the sites conveyed to subsidiary companies controlled by Mr. Bell apparently purely as a matter of convenience. Finance had, of course, to be obtained, and so advances on mortgages were obtained for these companies from some "financier". A noteworthy feature is that the advances to those companies might exceed the purchase price of the sites, but this was due to the value provided by the plaintiff company's possession of planning consent and the enhanced values which would be produced by the development on the sites of housing estates. For this purpose building leases of the sites were granted to the plaintiff company, and this was a condition of the advances made to the companies. The sums advanced were repaid when the purchasers of the houses paid for them by means of loans from building societies obtained in the ordinary way.

It is obvious that in order to finance these transactions Mr. Bell and his company, the plaintiff company, had to know of persons who were willing to provide the finance, and knowledge of such sources was a matter of value. Four of such transactions took place with a financing company called Nestlé's Pension Trust, Ltd. ("the Trust"), two of the transactions being with a company called Maes-y-Tannau Estates, Ltd., and the others being with companies called Pont Faen Investments, Ltd. and Golden Court (Richmond), Investments, Ltd. An argument was put forward on behalf of the defendants (City Wall Properties, Ltd.) that these were transactions between the trust and these three companies and not the plaintiff company. It is true that the plaintiff company held no shares in these companies, but they were controlled by Mr. Bell, the chairman of the plaintiff company. This argument seems to

me to ignore the reality that these properties were conveyed to and the advances by the trust made to these companies merely as the nominees of the plaintiff company and for the convenience of the business of the plaintiff company and for the convenience of the plaintiff Company. It is true that the plaintiff company held no shares in these companies, but they were controlled by Mr. Bell, the Chairman of the plaintiff company and were therefore not independent in fact. The reality is that this was all machinery to effect the plaintiff company's operation. In my opinion there is no substance in this point.

The way in which the defendants came into the matter was as follows. The plaintiff company had been approached by financiers, including apparently some Swiss financiers, with a view to the plaintiff company being financed in their business transactions from such sources. The plaintiff company had at the moment no development scheme for which the company could use the money, but in the course of a lunchtime meeting between Mr. Skeggs, who is a solicitor but was acting as the agent of the defendants in financial matters, and Mr. Bell it emerged that the defendants required finance to the extent of £1 million for the purpose of their current schemes – what was called "bridging finance". Mr. Skeggs said that this variety of bridging finance was extremely difficult to obtain. Mr. Bell intimated that he knew of sources from which such finance could be obtained. After a few abortive attempts to obtain it from other sources, eventually the money required was to be provided by the trust.

It is claimed by the plaintiff company that for this service the defendants agreed to pay a commission of £20,000 to Bell Houses. The introduction was effected, but the defendants refuse to pay to the plaintiff company the amount in question. In this action the plaintiff company claim payment of this sum as due from the defendants under the alleged agreement. Alternatively, the plaintiff company claims £20,000 damages on an implied term that the defendants would not prevent the plaintiff company earning the commission. The contract is denied in the defence, though (i) a letter of Mar. 2, 1962, from Mr. Skeggs to Mr. Bell, (ii) a letter of Mar. 5, 1962, from Mr. Bell to the surveyor of the trust, (iii) his reply to Mr. Bell of Mar. 6, 1962, (iv) a letter of Mar. 9, 1962, from Mr. Bell to Mr. Oppenheim, the chairman of the defendant company, and (v) a letter of Mar. 13, 1962, from Mr. Oppenheim to Mr. Bell, suggest the existence of a contract of the kind alleged; but this issue is not before us because a new point was taken by the defendants at the last moment.

The action came on for trial before MOCATTA, J., on Monday, June 28, 1965. On the previous Friday counsel for the defendants informed counsel for the plaintiff company that he had been instructed to take the point that the alleged contract was void as *ultra vires* the plaintiff company since it was not authorised by the objects clause in the plaintiff company's memorandum of association. The learned judge allowed the defence to be amended by adding the following paragraph:

> "The defendants will say that the agreement or agreement herein alleged by [the plaintiff company] were at all material times *ultra vires* [the plaintiff company] and void in that [the plaintiff company] under their memorandum of association had no power to enter into such agreement or agreements."

The result of this was that the action took a different turn: the matter raised by the amendment was heard and decided as a preliminary point.

The learned judge states in his judgment three separate points as arising for decision. (i) Can a defendant when sued on a contract by a company take the point that that contract is *ultra vires* the company? (ii) If he can do so when the contract is executory, can he do so or is the point relevant when the contract has been executed so far as the company's obligations are concerned? (iii) Assuming that the answers to the first two questions are in the affirmative, was the contract *ultra vires* the plaintiff company? The learned judge did not deal with the three points in that order; and, indeed, it is clear that if the answer on the third of the points is that the contract is not *ultra vires* the plaintiff company, the other two points do not arise. The learned judge decided the third point in the defendants' favour and dismissed the action. We, also, have heard the third point argued first, and in the result we have not found it necessary to hear argument on the other two points.

One point was raised and discussed in argument which is not really involved in the question of *ultra vires*, but which I suppose went to the basis of the contract alleged by the plaintiff company. It was argued on behalf of the defendants that the dealings with the defendants were conducted by Mr. Bell on his own behalf and not on behalf of the plaintiff company, so that the plaintiff company had no interest in the matter. This argument seems to me to be completely untenable. There is no evidence that Mr. Bell ever claimed the benefit of the £20,000 for himself. As has already been mentioned, Mr. Bell controlled the plaintiff company and administered it completely, and it is evident that he used the company for the purposes of the business. He was authorised by the resolution of the board of directors to conduct the administration of the company's business on behalf of the board, and it is impossible to suppose that he was distinguishing business negotiations carried out by him from the business of the company. Letters written by him in the course of this transaction were always written on the plaintiff company's notepaper, and though most of his letters were signed by his Christian name, that was in accordance with the terms on which these business men were and some of the letters, and in particular the letter of Mar. 9, 1962, to Mr. Oppenheim (the chairman of the defendants) were signed by Mr. Bell as "Chairman". Finally the action has been brought in the name of the plaintiff company. There is no doubt that if there was a contract to pay commission, the contract was made with the plaintiff company, through Mr. Bell.

Before I consider the provisions of the company's memorandum of association there is a point which I wish to make that affects the approach to this matter in regard to the plaintiff company's objects as stated in the memorandum. In order to give a more convincing air to their arguments, counsel for the defendants have treated the transaction which is under discussion as though it was a deliberate embarking by the plaintiff company on a serious new business of what counsel called "mortgage broking". In my opinion this is a false approach. From the plaintiff company's point of view it was not the opening of a new class of business intended to be carried on by the company on any serious scale. It was simply an isolated transaction which was intended to assist the defendants (since for the time being the plaintiff company could not avail itself of the financial opportunity because it has at the moment no site for development), to gain goodwill with not only the defendants but also with the trust, who were thereby to be enabled to carry out a profitable financial transaction. Besides these advantages to the plaintiff company, there was their own interest in getting to know a

financial source, since these development companies can only carry on their development business with the aid of borrowed money or temporary "bridging finance", or whatever they choose to call it. Surprisingly little money capital of their own is used in their operations, though, no doubt, plant and such like assets of their own are used by them. The transaction between the plaintiff company and the defendant is, of course, nonetheless a business transaction, even though larded with lunches and Christian names.

Clause 3 of the plaintiff company's memorandum of association contains the usual large number of sub-clauses, identified by the letters (a) to (u). It does not contain the provision sometimes inserted that all the sub-clauses are independent objects, or words to that effect. The following sub-clauses must be referred to:

> "(a) To carry on the trade or business of general, civil and engineering contractors and in particular but without prejudice to the generality of the foregoing to construct, alter, enlarge, erect and maintain either by [the plaintiff company] or other parties, sewers, roads, streets, railways, sidings, tramways, electricity works, gas works, bridges, shops, reservoirs, factories, water-works, brick kilns and brick or tile works, timber yards, buildings, houses, offices and all other works, erections, plant, machinery and things of any description whatsoever either upon land acquired by [the plaintiff company] or upon other land and generally.
>
> "(b) To acquire by purchase, exchange or otherwise either for an estate in fee simple or for any interest or estate in land, whether in possession or in reversion and whether vested or contigent, any lands, tenements and premises of any tenure, whether subject or not to any charges or incumbrances and any easements or other rights in or over land and any concessions, patents, patent rights, licences, copyrights, secret processes, machinery, plant, stock-in-trade and any other real or personal property and to hold or to sell, develop, let on rent, mortgage, charge or otherwise deal with all or any of such lands, tenements or premises and buildings erected thereon and all other such real and personal property.
>
> "(c) To carry on any other trade or business whatsoever which can, in the opinion of the board of directors, be advantageously carried on by [the plaintiff company] in connexion with or as ancillary to any of the above businesses or the general business of [the plaintiff company].
>
> "(m) To accept payment for any property or rights sold or otherwise disposed of or dealt with by [the plaintiff company].
>
> "(q) To sell, improve, manage, develop, turn to account, exchange, let on rent, royalty, share of profits or otherwise, grant licenses, easements and other rights in or over, and in any other manner deal with or dispose of the undertaking and all or any of the property and assets for the time being of the company for such consideration as [the plaintiff company] may think fit.
>
> "(u) To do all such other things as are incidental or conducive to the above objects or any of them."

Paragraph (m) was referred to but does not add anything material for present purposes. By cl. 5 the share capital of the plaintiff company is £ 2,100, of which £ 2,000 consists of

preference shares, which makes it obvious that the operations of the company must be financed by borrowing.

MOCATTA, J. was referred for the purposes of a summary of the law to the passage in **Buckley On *The Companies Act*** (13th Edn.) p. 23:

> "The doctrine that any act not authorised by the memorandum is *ultra vires* is to be applied reasonably. Anything fairly incidental to the company's objects as defined is not (unless expressly prohibited) to be held to be *ultra vires*. The question is not, however, whether the act or business not expressly authorised by the memorandum can conveniently or advantageously be done or carried on in conjunction with acts or business which are so authorised, but whether it is reasonably incidental or accessory thereto. Thus it is *ultra vires* for a company formed to work tramways to carry on either the business of an omnibus company or a general parcels collection and delivery business, however conveniently or advantageously such business can be combined with the tramways business."

Accepting this paragraph as substantially correct, the example given may be somewhat misleading.

The authorities cited for the example given are ***London County Council* v. *A. G.*** and ***A. G.* v. *Manchester Corpn*.** [(1901) 1 Ch 781 at pp. 784, 785] As regards the first of these cases the powers of the London County Council were statutory, being derived entirely under the London County Tramways Act, 1896, under which the council had been authorised to purchase the tramways undertaking. The decision of House of Lords was simply that running omnibuses was not incidental to running tramways. In the ***Manchester*** case the corporation were empowered by provisional orders and private Acts of Parliament to construct and maintained tramways, and there was a provision that "the tramways may be used for the purpose of conveying passengers, animals, goods, minerals, and parcels." The corporation proposed to carry on a general parcels delivery business both within and beyond the area covered by their tramways, not confined to parcels and goods carried on their tramways. This business was held by FARWELL, J., to be beyond their powers.

These two cases of statutory powers seem to me to be not directly relevant to a company formed under the Companies Acts the powers of which are established by the memorandum of association of the company with extensive detailed powers therein contained which have to be construed. For instance, in the present case, cl. 3 (c) of the plaintiff company's memorandum provided (among the company's objects) express power:

> "to carry on any other trade or business *whatsoever* which can, *in the opinion of the board of directors,* be *advantageously* carried on by the company in connexion with or as ancillary to any of the above businesses or the general business of the company."

This is the clause (amongst others) which has to be construed by the court in the present case, and I propose to construe the clause in the first place according to the words used in it, and to consider the authorities subsequently in order to see whether those compel us in any way to give a different meaning to the expressions in this memorandum.

For the moment I do not purpose to consider the effect produced by the words "in the opinion of the board of directors", though an important point is the effect of these words. In the first place, I would repeat the observation which I made earlier in this judgment: this is not a case where the company is deliberately launching out into a completely new field of business. There is no intention shown on the part of the company to indulge in a general mortgage broking business though some alternate openings for the application of the moneys of the trust were discussed while the negotiations with the defendants were proceeding and, at the end, a polite hope to do other business was mentioned.

It appears that the opportunity to do a good turn to the defendants and to gain the goodwill of the trust arose practically by accident. The facts mentioned above were plainly advantageous to the plaintiff company, as well as the prospective receipt of a sum of £20,000. In my view, this piece of business arose "in connexion with" the general business of the company and "as ancillary" to the general business of the company, which appears to be as described in sub-cl. (a) and sub-cl. (b) of cl. 3 of the memorandum. In the course of administration by Mr. Bell of the plaintiff company and its business or businesses, Mr. Bell had to find suitable sites for the development of housing estates and sources from which advances could be obtained for the purpose of financing the plaintiff company's operations. The knowledge thus acquired by Mr. Bell was a valuable asset and was not Mr. Bell's personal property but was the property of the company.

In my opinion the provisions of cl. 3 (q) are also applicable. This sub-clause empowers the plaintiff company (amongst other things) to "turn to account", and to "deal with or dispose of", "all or any of the property and assets for the time being of [the plaintiff company] for such consideration as [the plaintiff company] may think fit." It seems to me that in communicating to the defendants information as to sources of finance, Mr. Bell, in the administration of the company, was turning to account, dealing with and disposing of an asset of the company as authorised by this sub-clause.

Finally, there is the general provision in cl. 3 (u) of the plaintiff company's memorandum but it does not seem to be necessary for the plaintiff company to rely on this sub-clause in the present case.

I now turn to the authorities. ***Ashbury Railway Carriage and Iron Company* v. *Riche*** is, of course, the leading authority on the relation of companies formed under the Companies Acts to *ultra vires*. That case established that a company formed under the Companies Acts is not thereby created a corporation with inherent common law powers. It established that the powers of such a company are limited to the objects stated in the company's memorandum of association. Any contract made outside these powers is not necessarily illegal, but it is void and is not binding on the company. It cannot be ratified by the united desire of all the shareholders. That is the approach which must be made to the problem in the present case; but if in the present case we find that the contract was within the powers conferred by the plaintiff company's memorandum of association on its proper construction, then the contract is one which the plaintiff company can make, and objection falls to the ground.

The cases on which counsel for the defendants particularly relied as showing that the objects in the company's memorandum of association did not cover the contract alleged in the

present case, were early cases in the history of company law and were decided soon after the passing of the Companies Act, 1862. They are not necessarily bad law for that reason, but it seems to me that they were somewhat special cases, in which a complete departure from the real objects of the company had been attempted. In ***Joint Stock Discount Co.*** **v** ***Brown*** [(1866) L.R. 3 Eq. 139], the objects for which the company was established were stated to be

> "the carrying on the business of a bill-broker and scrivener; the drawing, accepting, endorsing, discounting, and rediscounting bills of exchange and promissory notes; the making advances and procuring loans on, and the investing in, securities; the borrowing and lending of money; the guaranteeing payment of bills of exchange, promissory notes, and advances; and the doing of all such things as the directors shall consider incidental or conducive to the attainment of the above objects."

Shares in a banking company called Barned's Banking Co., Ltd. were paid for out of the company's money and transferred into the names of some of the directors as nominees of the company, pursuant to a resolution of the board of directors [(1866), L.R. 3 Eq. at p.141]:

> "That as the board consider that the formation of a limited joint stock bank on the basis of the absorption of the old firm of Messrs. J. Barned & Co., of Liverpool, will be most conducive to the interests of the company by increasing its connexions, the company, or its nominees, assist the same by applying for ten thousand shares in the proposed bank on the terms above stated."

Orders were subsequently made for the winding-up of both the company and Barned's Bank and a bill was presented by the liquidator of the company on its behalf alleging that the acquisition of the shares was *ultra vires*. One of the directors demurred to the bill. SIR WILLIAM PAGE WOOD, V.C., overruled the demurrer and directed that the charges in the bill must be answered. The Vice-Chancellor made observations to the effect that in his view the suggestion that if shares were bought in the bank there would be some control over the business of the discounting was wholly unwarranted by the plainest rules of construction which, he said, "must limit the company's powers to those transactions which are naturally conducive to the objects specified." It is easy to see why counsel for the defendants relied on this case; but in fact the decision merely was that the allegations in the bill must be answered. The objection that one limited company could not take shares in another limited company though authorised by its memorandum, was disposed of by ***Re Barned's Banking Co., Ex p. Contract Corpn***. and in fact ***Joint Stock Discount Co.*** **v.** ***Brown*** was a simple case of fraud.

The other case most relied on by counsel for the defendants was ***Re German Date Coffee Co***. [(1881-85) All ER 372]. The company was formed to work a German patent for manufacturing coffee from dates, and the memorandum contained powers to acquire other inventions for similar purposes and to import and export all descriptions of produce for the purpose of food. The intended German patent was never granted, but the company purchased a Swedish patent and established works in Hamburg where it made and sold coffee made from dates without a patent. A petition was presented by two shareholders for the winding-up of the company and it was held by KAY, J., and by the Court of Appeal that the substratum of the company had failed, and it was impossible to carry out the objects for which it was

formed, and therefore it was just and equitable that the company should be wound up. LINDLEY, L.J., said:

> "The first question we have to consider is: What is the fair construction of the memorandum of association? It is required by the Companies Act, 1862, that the memorandum shall state what the objects of the company are. In construing this memorandum of association, or any other memorandum of association in which there are general words, care must be taken to construe those general words so as not to make them a trap for unwary people. General words construed literally may mean anything...; but they must be taken in connexion with that shown by the context to be the dominant or main object or objects of the company. It will not do, under general words, to turn a company for manufacturing one thing into a company for importing something else, however general the words are. Taking that as the governing principle, it appears to me to be plain, beyond all reasonable dispute, that the real object of this company, which is called 'The German Date Coffee Co., Ltd.', was to manufacture a substitute for coffee in Germany under a patent which is valid according to German Law. All the rest is subordinate to that main object, and that is what the people subscribe their money for, although the words are general."

Of course, as SALMON, L.J., observed in the course of the argument, if the company's main business is given up, something else cannot be ancillary to it. There is no suggestion that the plaintiff company has given up or is going to give up its main business of developing housing estates. That is sufficient to distinguish ***Re German Date Coffee Co***. from the present case.

As I have mentioned, it is also necessary to consider the effect of the words in cl. 3 (c) of the memorandum, "in the opinion of the board of directors." I think that it is plain that these words qualify the whole of that sub-clause. Counsel for the defendants contended that the opinion of the directors must not only be *bona fide* but also objective. MOCATTA, J., even went so far as to say that

> "the mere fact that the board of directors of a company may be of opinion that an activity can be advantageously carried on by the company, even if the opinion be well-founded, will not *per se* make that activity *intra vires*."

With all respect to the judges, if he is meaning to refer to the opinion required by the sub-clause, he is not quoting it correctly. The requirement of the sub-clause is that in the opinion of the board of directors the other trade or business can be advantageously carried on by the company in connexion with or as ancillary to any of the above businesses or the general business of the company. If the judge means that the opinion of the directors has no effect at all, then I am afraid that I cannot agree with him. On the balance of the authorities it would appear that the opinion of the directors if *bona fide* can dispose of the matter; and why should it not decide the matter? The shareholders subscribe their money on the basis of the memorandum of association and if that confers the power on directors to decide whether in their opinion it is proper to undertake particular business in the circumstances specified, why should not their decision be binding? The shareholders by taking shares on the terms of the memorandum have agreed to it. It is a matter of internal management principally. Persons

dealing with the plaintiff company in the course of trade or business are helped rather than hindered by a provision of this sort. In the result the judge appears to have completely disregarded this provision and to have dealt with the case on the basis that there was no real difference between sub-cl. (c) and sub-cl. (u).

In ***London Financial Association*** **v.** ***Kelk*** [(1884), 26 Ch. D. 107] the objects clause ended with the words "and the doing of all matters and things which may appear to the company to be incident or conducive to the objects aforesaid or any of them." SIR JAMES BACON, V.C., in the course of a long judgment discussed the effect of the words, and seems to have thought that they had some purpose and effect but they had to be limited by reference to the objects of the company. This is no doubt so, but in many case SIR JAMES BACON, V.C., held that the transaction, which was connected with the unfortunate Alexandra Palace which was burnt down on June 2, 1873, almost immediately after completion, was within the company's powers, distinguishing the ***Ashbury*** case.

In ***Cotman*** **v.** ***Brougham*** [(1918-19) All ER Rep. 265] a company called the Essequibo Rubber & Tobacco Estates, Ltd. agreed to sub-underwrite twenty thousand shares in another company and 17,200 of those shares were allotted to it, on which there remained due and owing the sum of £14,456 for unpaid calls. These shares were transferred to a third company. All three companies were in liquidation, and the liquidator of the second company settled the transfree company on the A list of contributories and the Essequibo Co. on the B list in respect of the shares. The liquidator of the Essequibo Co. applied to have that company's name struck out of the B list, on the ground that the underwriting was *ultra vires* of the company. The company's memorandum had thirty clauses enabling the company to carry on almost any kind of business, and the objects clause concluded with a declaration that every sub-clause should be construed as a substantive clause and not limited or restricted by reference to any other sub-clause or by the name of the company and that none of such sub-clauses or the objects specified therein should be deemed subsidiary or auxiliary merely to the objects mentioned in the first sub-clause. It was held that the memorandum must be construed according to its literal meaning, and that the underwriting was *intra vires*.

In ***Associated Artists, Ltd.*** **v.** ***Inland Revenue Comrs***. [(1956) 2 All E.R. 583], the first object in the memorandum of a company limited by guarantee was (a) to present classical, artistic, cultural and educational dramatic works, etc., and, after a number of sub-clauses, there was sub-cl. (1) "To do all such other things as are incidental or which [the taxpayer] may think conducive to the attainment of any of the above objects." It was held by UPJOHN, J., that the association was not a body established exclusively for charitable purposes. UPJOHN, J., held that the powers in sub-cl. (1) were independent of and not ancillary to the other objects, and that that clause was of itself sufficient to render the objects of the association not charitable, since the court in deciding whether any activity of the association was *ultra vires* would have to decide whether the association thought that it was conducive to the attainment of any of the objects of the association and what the association might think conducive would not necessarily be so.

The result of these authorities, in my opinion, is to establish that a clause on the lines of sub-cl. (c) in the present case is able to make the *bona fide* opinion of the directors sufficient to decide whether an activity of the plaintiff company is *intra vires*. There was, in the present

case, no resolution of the board of directors expressing the opinion of the board; but I do not think that such a resolution was necessary and I do not understand that it was contended that a resolution was necessary. In fact Mr. Bell managed the operation of the plaintiff company and exercised by delegation the functions of the board of directors, as he was entitled to do, by virtue of the resolution of the board of directors of June 10, 1955. It was Mr. Bell's opinion which decided whether certain business activities should be carried out on behalf of the plaintiff company. Mr. Bell's opinion is evident from what he did and from his evidence. Further, the facts support his opinion. For the reasons which I have mentioned earlier in this judgment, this transaction was justified and was within the powers of the plaintiff company under the terms of cl. 3 (c). The position is also assisted by the terms of sub-cl. (q) and sub-cl. (u). I feel no doubt that the transaction with the defendants was within the powers of the company and was not *ultra vires*.

The result is that the question whether a defence of *ultra vires* could be raised by the defendants does not arise and we have not thought it necessary to have it argued.

In my opinion the appeal should be allowed, and the preliminary point decided in the plaintiff company's favour.

* * * * *

Re Introductions, Ltd.
Introductions, Ltd. v. *National Provincial Bank Ltd.*

[1969] 1 All E.R. 887

HARMAN, L.J. – This is an appeal from BUCKLEY, J.'s decision, on a summons in the liquidation of this company raising the question whether the debentures held by the defendant bank are valid against the liquidator or are void as being tainted by the doctrine of *ultra vires*. The judge decided two questions. First, whether the activity in question was within the powers of the company: that he answered in the negative, and there is no appeal from that. The second question, which is the subject of the appeal, was whether in borrowing the money in question the company was acting within its powers and could give the bank a valid security.

This company started its career in 1951 in connection with the Festival of Britain and facilities to be afforded to visitors from abroad in connection with that event. It had an issued capital of £400. Subsequently for some years after 1953 it carried on a business connected with deck chairs at a seaside resort. From 1958 to 1960 it carried on no business but in the latter year there was a transfer of shares and a new board was elected which decided to make use of the company for a venture connected with pigs. It has always been the ambition apparently of the commercial community to stretch the objects clause, thus getting the advantage of limited liability with as little fetter on the activities of the company as possible. As LORD DAVEY said, the little man starting a grocery business usually combined groceries with power to bridge the mighty Zambesi; but still one cannot have an object to do every mortal thing one wants, because that is to have no object at all. There was one thing that this company could not do and that was to breed pigs. The venture of pig-breeding is the type of adventure which has always drawn money from the pockets of the British public, who apparently much prefer to regard themselves as owners of an apple or an apple tree or a pig rather than a mere share in a company. Anyhow this venture, like other similar ventures, has been a disastrous failure, and the company was ordered to be wound up in 1965.

In 1960 the then new directors approached the defendant bank with a view to opening an account. This account became in due course of time heavily overdrawn, and the defendant bank, requiring security, were offered two debentures secured on the company's assets. It is common ground that before the security was given the defendant bank was furnished with a copy of the memorandum and articles of association and also became aware, and expressly aware, that the company was carrying on as its sole business the business of pig-breeding, which it has now acknowledged was *ultra vires* its memorandum. The bank has however relied on the fact that there is in the memorandum a sub-cl. (N) [*(Sub-clause (N) was in these terms: "To borrow or raise money in such manner as the company shall think fit and in particular by the issue of debentures or debenture stock perpetual or otherwise and to secure the repayment of any money borrowed or raised by mortgage charge or lien upon the undertaking and the whole or any part of the company's property or assets whether present or future including its uncalled capital and also by a similar mortgage charge or lien to secure and guarantee the performance by the company of any obligation or liability it may undertake*] empowering the company in general terms to borrow, in particular by the issue of

debentures, and to secure the loan by charge. There is also in this memorandum a form of words which is common enough and has been for many years; and the words are these:

> "It is hereby expressly declared that each of the preceding sub-clauses shall be construed independently of and shall be in no way limited by reference to any other sub-clause and that the objects set out in each sub-clause are independent objects of the company."

Of course the original idea of that form of words was to avoid the old difficulty, which was that there was a main objects clause and all the others were ancillary to the main objects; and many questions of *ultra vires* arose out of that.

It was argued that the only obligation of the defendant bank was to satisfy itself that there was an express power to borrow money and that this power was converted into an object by the concluding words which I have read. It was said that if this was so not only need the defendant bank enquire no further but they were unaffected by knowledge that they had that the activity on which the money was to be spent was one beyond the company's powers.

The judge rejected this view, and I agree with him. He based his judgment, I think, on the view that a power or an object conferred on a company to borrow cannot mean something in the air: borrowing is not an end in itself and must be for some purpose of the company; and as this borrowing was for an *ultra vires* purpose that is an end of the matter.

Counsel for the defendant bank I think agreed that if sub-cl. (N) must in truth be construed as a power, such a power must be for a purpose within the company's memorandum. He says that it is "elevated into an object" (to use his own phrase) by the concluding words of the memorandum and this object, being an independent object of the company, will protect the lender and that that is its purpose. I answer that by saying that you cannot convert a power into an object merely by saying so. Sub-clause (N) cannot in truth stand by itself any more than certain other of the clauses of this memorandum, for instance sub-cl. (D), which states

> "To carry on any other trade or business... which can in the opinion of the board...be advantageously carried on... in connection with or as ancillary to any of the above businesses..."

Then there is sub-cl. (I), which is, to promote any other company for the purpose of acquiring any property or rights or converting any of the liabilities of this company or of its undertaking. And there are other similar sub-clauses which are clearly ancillary powers although under the concluding words they are stated to be independent objects.

Counsel for the defendant bank relied on the well-known case, ***Cotman* v. *Brougham*** [(1918) AC 514] and, in particular, the speech of Lord Parker of Waddington, where one finds this passage:

> "A person who deals with a company is entitled to assume that a company can do everything which it is expressly authorised to do by its memorandum of association, and need not investigate the equities between the company and its shareholders."

I would agree that if the defendant bank did not know what the purpose of the borrowing was it need not enquire, but it did know, and I can find nothing in ***Cotman* v. *Brougham*** to protect it notwithstanding that knowledge.

An earlier case, ***Re David Payne & Co. Ltd., Young* v. *David Payne Co., Ltd.*** [(1904) 2 Ch. 608] shows the limit to which this particular doctrine can go. The first words of the headnote are as follows:

> "Where a company has a general power to borrow money for the purpose of its business, a lender is not bound to enquire into the purpose for which the money is intended to be applied, and the misapplication of the money by the company does not avoid the loan in the absence of knowledge on the part of the lender that the money was intended to be misapplied."

I do not think I need read the passage of BUCKLEY, J.'s judgment [(1904) 2 Ch. at p. 612] in the case on which I rely.

I agree with the judge [(1968) 2 All E.R. at p. 1227] that it is a necessarily implied addition to a power to borrow, whether express or implied, that one should add "for the purposes of the .... company." This borrowing was not for a legitimate purpose of the company; the bank knew it and therefore cannot rely on its debenture. I would dismiss the appeal.

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DOCTRINE OF INDOOR MANAGEMENT

The Royal British Bank v. *Turquand*

[1843-60] All ER Rep. 435

Plaintiff declared against defendants, a joint stock Company completely registered under stat. 7 & 8 Vict. c. 110, on a bond, signed by two directors, under the seal of the Company, whereby the Company acknowledged themselves to be bound to plaintiff in £2,000. The plea set out the condition, which appeared to be for securing to the plaintiff, who was a banker, such sum as the company should, to the amount of £1,000, owe to plaintiff on the balance of the account current, from time to time, and for indemnifying plaintiff to that amount from losses incurred by reason of the account between plaintiff and defendants. The plea further set out clauses of the registered deed of settlement, by which it appeared that the directors were authorized, under certain circumstances, to give bills, notes, bonds or mortgages: and one clause provided that the directors might borrow on bond such sums as should, from time to time, by a general resolution of the Company, be authorized to be borrowed. The plea averred that there had been no such resolution authorizing the making of the bond, and that it was given without the authority of the shareholders.

The replication set out the deed of settlement further, by which it appeared that the Company was formed for the purpose of carrying on mining operations and forming a railway - On demurrers to the plea and replication, held, by the Court of Exchequer Chamber, affirming the judgment of Q.B., that plaintiff was entitled to judgment, the obligee having, on the facts alleged, a right to presume that there had been a resolution at a general meeting, authorizing the borrowing the money on bond–Semble, per Jervis C.J., that such resolution would confer sufficient authority if it authorized the borrowing on bond of such sums as the directors might deem expedient, in accordance with the statute and deed, without otherwise defining the amount.

The plaintiffs declared against the defendant, as official manager of Cameron's Coalbrook Steam, Coal, and Swansea and London Railway Company, according to The Joint Stock Companies Winding up Acts (the Company being completely registered under stat. 7 & 8 Vict. c. 110). The declaration alleged that the Company, before defendant became official manager, to wit on 6th March 1850, by their writing obligatory, sealed with their common seal, acknowledged themselves to be held and firmly bound to plaintiffs in £2,000, to be paid to plaintiffs on request; for which payment the said last mentioned Company did bind themselves and their successors. Yet the said sum, or any part thereof, has not been paid.

Plea (1), in which was set out the condition, which appeared to be for securing to the plaintiffs, who were bankers, such sum as the Company should, to the amount of £1,000, owe to plaintiffs on the balance of the account current, from time to time, and for indemnifying plaintiffs to that amount from losses incurred by reason of the account between plaintiffs and the Company. The plea further set out clauses of the registered deed to settlement of the Company. The plea further set out clauses of the registered deed to settlement of the Company, by which it appeared that the directors were authorized, under certain circumstances, to give bills, notes, bonds or mortgages: and one clause provided that the

directors might borrow on bond such sums as should, from time to time, by a general resolution of the Company, be authorized to be borrowed. The plea averred that there had been no such resolution authorizing the making of the bond, and that the same was given and made without the authority or consent of the shareholders of the Company.

The replication set out the deed of settlement further, by which it appeared that the Company was formed for the purpose of carrying on mining operations and forming a railway. It then alleged that, at a general meeting of the Company it was resolved "that the directors of the said Company should be, and they were thereby, authorized to borrow on mortgage, bond or otherwise, such sums for such periods and at such rates of interest as they might deem expedient, in accordance with the provisions of the deed of settlement and Act of Parliament. And the said resolution and determination has thence hitherto remained unrescinded." The replication then alleged that afterwards, in accordance with the authority granted by the general meeting, the directors agreed to enter into the bond, and appointed two directors to affix their seal, and the secretary to sign the bond, which bond, so sealed and signed, plaintiffs took "in full faith and belief of the validity of the said resolutions, and that the said bond was authorized by, and would be a valid and binding security upon, the said Company."

Phipson, for the party suggesting error. The plea answers the declaration; it amounts to a special *Non est factum*. Stat. 7 & 8 Vict. c. 110, s. 25, limits the powers of the Company to the acts which are authorized by the deed of settlement; and here the deed of settlement limits the power of borrowing on bond by the directors to cases where such borrowing is authorized by a resolution passed at a general meeting of the Company. The plea alleges that there has been no such resolution. The bond therefore, being sealed without authority, is not the bond of the Company. The Court below assumes that the bond is allowed to be under the seal of the Company, and to be their bond: whereas the plea insists that this is not so. The ground therefore, suggested by the court below, of distinction between this case and ***Ridley* v. *Plymouth Grinding and Baking Company*** [2 Exch. 711], ***Kingsbridge Flour Mill Company* v. *Plymouth Grinding and Baking Company*** [2 Exch. 718], ***Smith* v. *The Hull Glass Company*** [11 Com. B. 897], and ***Greenwood*** case [3 De G. Macn. & G. 459], disappears. The judgment below states that no illegality appears on the face of the bond or condition, and infers, from ***Collins* v. *Blantern*** and ***Paxton* v. *Popham*** [9 East, 408], that the plea should allege facts showing illegality. But in those cases it was admitted that the bond was duly executed, and the plea was by way of confession and avoidance. [Bramwell B. I think that, in ***The East Anglian Railway Company* v. *The Eastern Counties Railway Company*** [11 Com. B. 775], I urged, without success, the argument that the deed was admitted, on the record to be the deed of the defendants]. And there the covenant was under the common seal. The defendants have no power besides what the statute confers; and the statute refers to the deed: the case is not like that of ordinary partners, each of whom has a prima facie authority to bind the firm in matters relating to the business of the firm; an authority which cannot, as against other parties, be restrained by a private agreement among the partners themselves. The plaintiffs were bound to know the statute and the contents of the deed of settlement. [Crowder, J. That appears to be the view of Parke B. in ***Ridley* v. *Plymouth Grinding and Baking Company*** [2 Exch. 711]. The same view is taken by Jervis CJ. And Maule J., in ***Smith* v. *The Hull Glass Company*** [11 Com. B. 897]; though there judgment was given for

the plaintiffs on the ground that the goods were supplied for the purposes of the trade of the defendants, and were, with their knowledge, received and so used. [Bramwell B. Suppose all the members of the Company had joined in affixing the seal]. The affixing would not be an act of the Corporation. The judgment below relies upon ***Hill* v. *The Manchester and Salford Water Works Company*** [2 B. & Ad. 544] and ***Horton* v. *Westminster Improvement Commissioners*** [7 Exch. 780]. But in ***Hill* v. *The Manchester*** and ***Salford Water Works Company*** (2 B. & Ad. 544) the company were authorized to raise a certain sum; there was no statutory restriction as to the modes of executing the powers; and there was nothing to shew that all the shareholders had not been parties to the instrument. In ***Horton* v. *Westminster Improvement Commissioners*** [7 Exch. 780] the decision on the seventh plea was on the language of the plea, which did not bring the defence within the words of the statute.

The replication does not satisfy the condition imposed by the deed of settlement, inasmuch as the resolution set forth does not specify the sum to be borrowed.

JERVIS CJ. - I am of opinion that the judgment of the Court of Queen's Bench ought to be affirmed. I incline to think that the question which has been principally argued both here and in that Court does not necessarily arise, and need not be determined. My impression is (though I will not state it as a fixed opinion) that the resolution set forth in the replication goes far enough to satisfy the requisites of the deed of settlement. The deed allows the directors to borrow on bond such sum or sums of money as shall from time to time, by a resolution passed at a general meeting of the Company, be authorized to be borrowed: and the replication shows a resolution, passed at a general meeting, authorizing the directors to borrow on bond such sums for such periods and at such rates of interest as they might deem expedient, in accordance with the deed of settlement and the Act of Parliament; but the resolution does not otherwise define the amount to be borrowed.

That seems to me enough. If that be so, the other question does not arise. But whether it be so or not we need not decide; for it seems to us that the plea, whether we consider it as a confession and avoidance or a special non est factum, does not raise any objection to this advance as against the Company. We may now take for granted that the dealings with these companies are not like dealings with other partnerships, and that the parties dealing with them are bound to read the statute and the deed of settlement. But they are not bound to do more. The party here, on reading the deed of settlement, would find, not a prohibition from borrowing, but a permission to do so on certain conditions. Finding that the authority might be made complete by a resolution, he would have a right to infer the fact of a resolution authorizing that which on the fact of the document appeared to be legitimately done.

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Freeman and Lockyer v. *Buckhurst Park Properties (Mangal), Ltd.*

[1964] 1 All E.R. 630

The defendant company appealed against an order of His Honour JUDGE HERBERT, Q.C., made on May 2, 1963, ordering that the plaintiffs recover from the defendant company the sum of £291 Gs. for debt. The grounds of appeal were that: (i) there was no evidence that either at the time of the making of the contract sued on or at all the second defendant had any apparent authority to act on behalf of the defendant company in employing the plaintiffs or any other surveyors, (ii) the judge was wrong in law and misdirected himself in that the plaintiffs were not entitled to rely on any ostensible or apparent authority in the second defendant in that there was no evidence that the plaintiffs relied on such authority and the plaintiffs did not rely on such authority in making the contracts sued on; (iii) there was no evidence on which the judge could find that the second defendant asked the plaintiffs to do the work sued on for the defendant company; (iv) there was no evidence on which the judge could find that the plaintiffs thought that they were being instructed on behalf of the defendant company; (v) there was no evidence on which the judge could find that the second defendant had been acting as managing director or so acting to the knowledge of the defendant company's board.

WILLMER, L.J. – The plaintiffs, who carry on business as architects and surveyors, bring this action to recover fees alleged to be due to them in respect of work done during the autumn of 1959 in relation to Buckhurst Park Estate at Sunninghill, the property of the defendant company. The plaintiffs received their instructions in August, 1959, from the second defendant, one Mr. Kapoor, who was at all material times a director of the defendant company. The plaintiffs admittedly executed the work which they were employed to do, and there is no dispute as to the quantum of the fees earned by them, viz., £ 291 6s. The question is whether the liability in respect of those fees is that of the defendant company or that of the second defendant, Mr. Kapoor. By an amendment Mr. Kapoor was added as second defendant, but at all material times up to the date of trial his whereabouts were unknown, and he was never served with the proceedings. The action accordingly proceeded against the defendant company alone. The trial took place before His Honour JUDGE HERBERT at Westminster Country Court on three days during March and April, 1963, and by a reserved judgment which he delivered on May 2, 1963, he found in favour of the plaintiffs. The defendant company now appeals to this court, contending that the liability is not theirs but that of the second defendant.

It appears that the second defendant was a gentleman who carried on business as a property developer, i.e., his business was to purchase properties for the purpose of developing them. His practice was, as and when he purchased a property, to form a company for the purpose of dealing with it.

In September, 1958, the second defendant entered into a contract to purchase Buckhurst Park Estate for a sum of £75,000. Unfortunately for him he had not sufficient cash resources to enable him to complete the purchase. In these circumstances he sought and obtained assistance from a Mr. Hoon, who was willing to advance a sum of approximately £40,000.

On Oct. 11, 1958, the two men entered into a written agreement (a copy of which is before us) whereby they agreed to form a private limited company with a nominal capital of £70,000 which they were to subscribe in equal shares. The directors of the company were to be the second defendant and Mr. Hoon and a nominee of each. The object of the company was as soon as practicable to complete the purchase of the Buckhurst Park Estate. In due course the defendant company was formed, and it was provided by art. 12 of the articles of association that the directors were to be the second defendant and Mr. Hoon, together with Mr. Cohen (described in the memorandum of association as a company director but in fact a managing clerk employed by the second defendant's solicitors), who was the second defendant's nominee, and Mr. Hubbard (a managing clerk employed by Mr. Hoon's solicitors) who was Mr. Hoon's nominee. Article 14 of the articles of association made provisions for alternate directors to act in the place of any director who might be unable to be present at a meeting. By art. 19 it was provided that the quorum necessary for the transaction of the business of the directors should be four. After entering into the agreement with the second defendant, and even before the formation of the company, Mr. Hoon went abroad, and thereafter was at all material times out of the country except for a short period from June to August, 1959. In his absence he left his interest to be protected by his nominee, Mr. Hubbard. It was clearly never contemplated that Mr. Hoon should take any material part in the management of the company. Whatever the legal formalities, the substance of the transaction was a loan by Mr. Hoon to the second defendant to enable him to acquire and resell the Buckhurst Park Estate. The second defendant in fact thought that he had a purchaser in view, and expected to make a quick profit, which it was agreed should be shared equally between him and Mr. Hoon. Unfortunately for both of them, the prospective purchaser never materialised.

The property was duly conveyed to the company, and the minutes of the first meeting of the board held on Dec. 11, 1958, record that it was resolved that the company's seal should be affixed to the conveyance. It had been agreed between the second defendant and Mr. Hoon that, pending resale of the property, the running expenses of maintaining it were to be defrayed by the second defendant personally, and that he was to be reimbursed out of the profit of the resale. This agreement appears to have been accepted by the board, although I cannot find that it was ever the subject of any resolution at a board meeting. A board meeting was held on April 3, 1959, by which time it is clear from the minutes that any prospect of a quick resale of the property had already disappeared.

In the summer of 1959 the second defendant instructed an architect, one Mr. Hayler, to make application for planning permission for certain development in respect of Buckhurst Park Estate. So far as concerned the work done in respect of the Buckhurst Park Estate, Mr. Freeman gave evidence, which was corroborated by Mr. Mackay, that he was instructed by the second defendant on behalf of the defendant company. This evidence was specifically accepted by the judge.

About the time that the plaintiffs were first instructed, Mr. Hoon was in this country; but he was not apparently consulted about the matter, and there is no minute of any resolution of the board authorising the employment of the plaintiffs. Throughout the autumn of 1959 the plaintiffs were in constant communication in relation to the work which they were doing both with the second defendant personally and with Mr. Macklay at the office of Reevaham, Ltd.

Throughout the whole of this correspondence no mention whatsoever of the defendant company's name is to be found. On the face of it the plaintiffs were purporting to act entirely for the second defendant personally. The appeal from the refusal of planning permission was submitted in his name, and a certificate under s. 37 of the Town and Country Planning Act, 1959, was submitted by the plaintiffs certifying that the second defendant was the estate owner in respect of every part of the land to which the appeal related. These circumstances were strongly relied on at the trial as going to show that the plaintiffs throughout were regarding the second defendant as their employer, and that they were looking exclusively to him for payment of their fees. The explanation which Mr. Freeman gave in evidence was that he simply identified the second defendant in his own mind with the defendant company. As I have said, however, the judge specifically accepted Mr. Freeman's evidence that he was instructed by the second defendant on behalf of the defendant company, and counsel for the defendant company has not sought to challenge this finding. Having regard to this, the fact that in the correspondence the plaintiffs throughout appeared to regard the second defendant personally as their employer loses its significance. The only question which remains is whether, in view of the fact that the second defendant contracted with the plaintiffs in the defendant company's name, the latter are bound by his act.

The plaintiffs contended: (i) that on the true inference from all the fact the second defendant had actual authority to engage the plaintiffs on behalf of the defendant company: alternatively (ii) that the second defendant was held out by the defendant company as having ostensible authority, so that the latter is estopped from denying responsibility for his acts. The submissions on behalf of the defendant company are conveniently summarised in paras 2 and 3 of the defence as follows:

> "(2) The said [second defendant] was at all material times a director of the [defendant company], but the [defendant company] denies that he was authorised expressly or impliedly to enter into the alleged or any agreement with the plaintiffs for and on behalf of the [defendant company]. (3) Further, or in the alternative, the [second defendant] at all material times acted without the knowledge and/or the approval of the [defendant company], and/or outside the scope of his authority as a director of the defendant company."

The judge found that the second defendant, although never appointed as managing director, had throughout been acting as such in employing agents and taking other steps to find a purchaser, and that this was well known to the board. In the light of this finding he gave judgment in favour of the plaintiffs, basing himself on the principles stated by LOPES, L.J., in ***Biggerstaff* v. *Rowatt's Wharf, Ltd., Howard* v. *Rowatt's Wharf, Ltd.*** [(1896) 2 Ch. 93, 104]. I take this to be a finding, not that the second defendant had actual authority to employ the plaintiffs, but that in doing so he was acting within the scope of his ostensible authority.

In this court the plaintiffs have adhered to their contention that the second defendant had actual authority to employ the plaintiffs; but I do not think that this view can be supported. Actual authority might, of course, be either express – e.g., if the second defendant were specifically authorised to engage the plaintiffs – or it might be implied – e.g., if the second defendant had been appointed to some office which carried with it authority to such a contract on behalf of the defendant company. There is certainly no resolution of the board specifically

authorising the second defendant to engage the plaintiffs. The articles of association, however, incorporate art. 102 and art. 107 of Table A, Part I, of the Companies Act, 1948. By the former, directors may delegate any of their powers to a committee of one. By the latter, they may appoint one of their body to the office of managing director. But there was never any resolution of the board whereby the directors here purported to exercise either of these powers. Nor can I find any trace of any resolution in writing signed by all the directors such as would be validated by art. 106 to the same extent as a resolution passed at a board meeting. In these circumstances I think that it is hopeless to contend that the second defendant was ever clothed with authority to do what he did.

The real question to be determined is whether the judge was right in finding that the second defendant had ostensible authority to engage the plaintiffs. This is partly a question of fact and partly one of law. So far as the facts are concerned, counsel for the defendant company has attacked the judge's finding that the second defendant acted throughout as managing director to the knowledge of the board. He has argued that there is no evidence to support this finding. I find myself unable to accept this submission. In my judgment there was abundant evidence; indeed, when the realities of the case are examined, I think that it is the only inference that could properly be drawn. I hope that I can summarise quite briefly the considerations which impel me to that conclusion. It is, I think, to be remembered that the whole of what I may call the Buckhurst Park Estate venture was essentially the second defendant's affair. It was he who had contracted to buy the property, and it was only because he could not find sufficient capital to pay for it that Mr. Hoon's assistance was enlisted and the defendant company was to resell the property as quickly as possible and to make the best possible profit. This was the evidence of Mr. Hoon himself. For this purpose it was clearly in the interest of the defendant company to obtain planning permission to develop the property, and that made it desirable, to say the least, that experts such as the plaintiffs should be engaged to act on behalf of the company. For most of the time with which we are concerned Mr. Hoon was out of the country and unable to take any part; he left nobody but a solicitor's managing clerk to act on his behalf as his nominee. The inference is that it was always intended that the second defendant should be the person to find the prospective purchaser. That this was indeed the plan is again confirmed by Mr. Hoon's own evidence. This, no doubt, explains why it was agreed that pending resale the second defendant should be responsible for the expenses of maintaining the property. This would provide the best possible incentive to him to find a purchaser as quickly as possible. It was Mr. Hubbard's evidence that the second defendant had authority for day to day management. This is in accordance with the letter of Sept. 2, 1959, written by the second defendant's solicitors acting for Mr. Hoon, in which they said:

> "We ... trust that you have now received your client's confirmation that he has at all times agreed that [the second defendant] should bear the responsibility for management of the property."

Mr. Hoon's solicitors did not write to confirm that this was so – at least no such letter is included in the bundle of correspondence before us; but the assertion made by the second defendant's solicitors was certainly never challenged. The judge also relied (and, I think,

rightly relied) on the minutes of the board meetings of April 3, 1959, and March 3, 1960. As to the latter, para 5 of the minutes records Mr. Hubbard as complaining:

> "that [the second defendant] had never given proper or full information to the board of the steps he had taken in the past to dispose of the property or of any application he had made for development."

This, I think, makes it clear that it must always have been contemplated by the board that the second defendant should not only manage the property, but should also be responsible for disposing of it and for making any planning application necessary for that purpose. That in turn must involve such steps as would ensure the best chances of resale – for instance, employing agents and surveyors to assist in obtaining the necessary planning permission. As to the minutes of the earlier meeting, although no quorum was present, they are of some evidential value as showing what was being done and what was in the minds of the directors at the time. These minutes were indeed relied on by counsel for the defendant company as showing that express authority was thought to be required to pay the fees of the agent who had been employed. He suggested that this would be inconsistent with the second defendant's having authority to engage agents or professional persons such as the plaintiffs without express authorisation. But as against that these minutes do show that as early as April, 1959, outside persons were being engaged with the approval of the board to assist in obtaining planning permission. It is true that it was Mr. Cohen, and not the second defendant, who raised the subject and reported on what had been done. But it is to be remembered that Mr. Cohen was the second defendant's nominee, and I think that the inference is that the various agents named had been engaged by the second defendant.

Lastly, I would refer to the fact that it was the defendant company's own case (and indeed a subject-matter of complaint on their part) that the second defendant was acting throughout as if he were himself the owner of the property. Thus it was complained that he appeared on television and behaved as if he were the owner. Reliance was also placed on the fact that the second defendant dealt with the plaintiffs themselves as if he were the owner of the property. All this, as it seems to me, goes to support the view that the second defendant was acting throughout as managing director. It is not without significance that when, on January 28, 1960, the local authority wrote to the defendant company's solicitors, explaining that the respective applications for planning permission had been submitted on behalf of the second defendant, as owner, the solicitors by their reply did no more than point out that the second defendant was not in fact the owner of the property, and never had been. No suggestion was made by them at that time that the second defendant was acting without the authority of the board in causing the respective applications for planning permission to be made. Having regard to all these considerations I can see no good ground for interfering with the judge's finding of fact that the second defendant throughout was, to the knowledge of the board, acting as managing director of the defendant company.

Counsel for the defendant company recognised that, if that finding be accepted, his task in challenging the judge's conclusion must be rendered so much the more difficult. Nevertheless, he submitted that in law the defendant company was entitled to succeed. The doctrine of ostensible authority in relation to a limited company necessarily gives rise to difficult legal problems. For a company can act only through its officers, and the powers of its

officers are limited by its articles of association. It is well established that all persons dealing with a company are affected with notice of its memorandum and articles of association, which are public documents open to inspection by all. However, by the rule in ***Royal British Bank* v. *Turquand,*** re-affirmed in ***Mahony*** case, it was also established, in the words of LORD HATHERLEY in the latter case,

> "that, when there are persons conducting the affairs of the company in a manner which appears to be perfectly consonant with the articles of association, then those dealing with them, externally, are not to be affected by any irregularities which may take place in the internal management of the company."

In the same case LINDLEY, L.J., said:

> "The persons dealing with him [the apparent managing director] must look to the articles, and see that the managing director might have power to do what he purports to do, and that is enough for a person dealing with him *bona fide*."

I take the lord justice to mean, not that persons dealing with the supposed managing director must actually look at the articles, but that, being affected with notice of them, they must have regard thereto. Consequently, if in that case the articles of association had conferred no power to appoint a managing director, the plaintiffs could not have been heard to say that the person with whom they contracted had been held out by the company as its managing director.

Though I have no doubt that ***Rama*** [(1952) 1 All lER 554] case was rightly decided on its own facts, I cannot agree with the view expressed by SLADE, J., that the previous decisions of this court were conflicting. I do not think that, when properly understood, the cases relied on by the defendant company here are in conflict with the decision in the ***British Thomson-Houston*** case [(1932) All ER Rep. 448] or with the principles which I have already stated. If I correctly understand them, the cases relied on by the defendant company deal with a much narrower point. They were all cases of most unusual transactions, which would not be within what would ordinarily be expected to be the scope of the authority of the officer purporting to act on behalf of the company. Thus in ***Houghton*** case [(1927) 1 KB 246] a director purported to make on behalf of his company an agreement with the plaintiffs whereby the plaintiffs were to sell on commission goods imported by the defendant company on terms that the plaintiffs should retain the proceeds of sale as security for a debt due form another company. In the ***Kreditbank*** case [(1927) All ER Rep. 421] a branch manager of a company carrying on business as forwarding agents purported to draw bills of exchange on behalf of his company, which he subsequently endorsed on their behalf. In ***Rama*** case a director of the defendant company purported to make an agreement with a director of the plaintiff company whereby the two companies were to join in subscribing to a fund to be used for financing the sale of goods produced by a third company, the defendant company being responsible for administering the fund and accounting to the plaintiffs. Thus in none of these cases were the plaintiffs in a position to allege that the person with whom they contracted was acting within the scope of such authority as one in his position would be expected to possess. There was accordingly no ground for saying that the officer in question was in fact being held out by the company as having authority to perform the act relied on. The plaintiffs indeed had nothing to

go on beyond the fact that in each case power to do the acts relied on might, under the articles of association, have been delegated to the person with whom they contracted. But in none of the cases did the plaintiffs have any knowledge of the articles of association.

In the circumstances the three decision relied on by the defendant company are to my mind no more than illustrations of the well established principle that a party who seeks to set up an estoppel must show that he in fact relied on the representation that he alleges, be it a representation in words or a representation by conduct.

In the present case the plaintffis do not have to rely on the articles of association of the defendant company in order to establish their claim. They are thus not caught by the ratio of the decision in ***Haughton*** case. The plaintiffs here rely on the fact that the second defendant, to the knowledge of the defendant company's board, was acting throughout as managing director, and was therefore being held out by the board as such. The act of the second defendant inengaging the plaintiffs was clearly one within the ordinary ambit of the authority of a managing director. The plantiffs accordingly do not have to enquire whether he was propertly appointed. It is sufficient for them that under the articles there was in fact power to appoint him as such.

In my judgment the judge here, having found that the second defendant was throughout acting as managing director to the knowledge of the board of the defendant company, rightly applied the principle enunciated by LOPES, L.J., in ***Biggerstaff*** case. I think that he came to the right conclusion, and I would accordingly dismiss the appeal.

PEARSON, L.J. - I agree. The defendant company was formed with a view to purchasing the Buckhurst Park property and making a quick and profitable resale, which was thought to be in prospect. After the defendants company had been formed and had purchased the property, the intended resale was not achieved. Thereafter, as the judge has found, the whole purpose of the defendant company was to dispose of the property as advantageously as possible. The second defendant was a director of the defendant company and he was, with the knowledge and approval of the other directors, carrying on the business of the defendant company. In the course of carrying on the defendant company's business and professing to act on its behalf, he instructed the plaintiffs to render the services for which they are claiming remuneration in this action. The instructions were to take over the conduct of a planning application and appeal relating to the property, and to survey and prepare a plan of the property, and the plaintiffs did that work. Clearly the instructions were within the natural and ordinary scope of the defendant company's business. That is a very short, but I think at this stage sufficient, summary of the judge's view of the facts of the case. There were difficult questions of fact to which he refers in his judgment, but his findings were to that effect, and there was undoubtedly evidence to support his findings, as WILLMER, L.J., has shown.

The ground of the judge's decision in favour of the plaintiffs is stated in these two sentences of his judgment:

> "In my judgment a company is bound by the acts of persons who take on themselves, with the knowledge of the directors, to act for the company, provided such persons act within the limits of their apparent authority, and strangers dealing *bona fide* with

such persons have a right to assume that they have been duly appointed... In my opinion, in the present case, the second defendant was acting as managing director, certainly as a director acting for the company with the knowledge of his board, and I hold that the company is bound by his action in employing the plaintiffs."

Rama Corpn., Ltd. **v.** ***Proved Tin and General Investments, Ltd***. [(1952) 1 All ER 554] was another case of an unusual transaction, and it was decided on the ground that the plaintiffs, having no knowledge of the defendant company's articles of association, could not claim to have acted in reliance on a provision for delegation contained therein. It was expressly recognised in the judgment:

"it is possible to have ostensible or apparent authority apart from the articles of association, though not where it is inconsistent with or beyond the articles of association."

In my view the judgment cannot reasonably be regarded as saying or implying that a person dealing with a director of a company in a normal transaction within the ordinary scope of the company's business is not protected by the director's ostensible authority, unless that person obtained and studied the company's articles of association and the incorporated provisions of Table A and made sure that the directors had power to delegate to a single director. Such a requirement would be an absurd example of legal pettifoggery. There is no difficulty in applying the principle of ***Rama*** case to any case where there is an unusual transaction outside the scope of the ordinary business which the single director is (in the sense indicated above) held out by the company as authorised to conduct on its behalf. In my judgment the interesting arguments presented for the defendants must fail, and the appeal must be dismissed.

DIPLOCK, L.J. - We are concerned in the present case with the authority of an agent to create contractual rights and liabilities between his principal and a third party whom I call "the contractor." This branch of the law has developed pragmatically rather than logically, owing to the early history of the action of assumpsit and the consequent absence of a general *jus quaesitum tertii* in English law. But it is possible (and for the determination of this appeal I think it is desirable) to restate it on a rational basis. It is necessary at the outset to distinguish between an "actual" authority of an agent on the one hand, and an "apparent" or "ostensible" authority on the other. Actual authority and apparent authority are quite independent of one another. Generally they co-exist and coincide, but either may exist without the other and their respective scopes may be different. As I shall endeavour to show, it is on the apparent authority of the agent that the contractor normally relies in the ordinary course of business when entering into contracts.

An "actual" authority is a legal relationship between principal and agent created by a consensual agreement to which they alone are parties. Its scope is to be ascertained by applying ordinary principles of construction of contracts, including any proper implications from the express words used, the usages of the trade, or the course of business between the parties. To this agreement the contractor is a stranger; he may be totally ignorant of the existence of any authority on the part of the agent. Nevertheless if the agent does enter into a contract pursuant to the "actual" authority, it does create contractual rights and liabilities

between the principal and the contractor. It may be that this rule relating to "undisclosed principals", which is peculiar to English law, can be rationalised as avoiding circuity of action, for the principal could in equity compel the agent to lend his name in an action to enforce the contract against the contractor, and would at common law be liable to indemnify the agent in respect of the performance of the obligations assumed by the agent under the contract.

An "apparent" or "ostensible" authority, on the other hand, is a legal relationship between the principal and the contractor created by a representation, made by the principal to the contractor, intended to be and in fact acted on by the contractor, that the agent has authority to enter on behalf of the principle into a contract of a kind within the scope of the "apparent" authority, so as to render the principal liable to perform any obligations imposed on him by such contract. To the relationship so created the agent is a stranger. He need not be (although he generally is) aware of the existence of the representation. The representation, when acted on by the contractor by entering into a contract with the agent, operates as an estoppel, preventing the principal from asserting that he is not bound by the contract. It is irrelevant whether the agent had actual authority to enter into the contract.

In ordinary business dealings the contractor at the time of entering into the contract can in the nature of things hardly ever rely on the "actual" authority of the agent. His information as to the authority must be derived either from the principal or from the agent or from both, for they alone know what the agent's actual authority is. All that the contractor can know is what they tell him, which may or may not be true. In the ultimate analysis he relies either on the representation of the principal, i.e., apparent authority, or on the representation of the agent, i.e., warranty of authority. The representation which creates "apparent" authority may take a variety of forms of which the commonest is representation by conduct, i.e., by permitting the agent to act in some way in the conduct of the principal's business with other persons. By so doing the principal represents to anyone who becomes aware that the agent is so acting that the agent has authority to enter on behalf of the principal into contracts with other persons of the kind which an agent so acting in the conduct of his principal's business has normally "actual" authority to enter into.

In applying the law, as I have endeavoured to summarise it, to the case where the principal is not a natural person, but a fictitious person, viz., a corporation, two further factors arising from the legal characteristics of a corporation have to be borne in mind. The first is that the capacity of a corporation is limited by its constitution, i.e., in the case of a company incorporated under the Companies Act, by its memorandum and articles of association; the second is that a corporation cannot do any act, and that includes making a representation, except through its agent. Under the doctrine of *ultra vires* the limitation of the capacity of a corporation by its constitution to do any acts is absolute. This affects the rules as to the "apparent" authority of an agent of a corporation in two ways. First, no representation can operate to estop the corporation from denying the authority of the agent to do on behalf of the corporation an act which the corporation is not permitted by its constitution to do itself. Secondly, since the conferring of actual authority on an agent is itself an act of the corporation, the capacity to do which is regulated by its constitution, the corporation cannot be estopped from denying that it has conferred on a particular agent authority to do acts

which, by its constitution, it is incapble of delegating to that particular agent. To recognise that these are direct consequences of the doctrine of *ultra vires* is, I think, preferable to saying that a contractor who enters into a contract with a corporation has constructive notice of its constitution, for the expression “constructive notice” tends to disguise that constructive notice is not a positive, but a negative doctrine, like that of estoppel of which it forms a part. It operates to prevent the contractor from saying that he did not know that the constitution of the corporation. It does not entitle him to say that he relied on some unusual provision in the constitution of the corporation, if he did not in fact so rely.

The second characteristic of a corporation, viz., that unlike a natural person it can only make a representation through an agent, has the consequence that, in order to create an estoppel between the corporation and the contractor, the representation as to the authority of the agent which creates his “apparent” authority must be made by some person or persons who have “actual” authority from the corporation to make the representations. Such "actual” authority may be conferred by the constitution of the corporation itself, as, for example, in the case of a company, on the board of directors, or it may be conferred by those who under its constitution have the powers of management on some other person to whom the constitution permits them to delegate authority to make representations of this kind. It follows that, where the agent on whose “apparent” authority the contractor relies has no “actual” authority from the corporation to enter into a particular kind of contract with the contractor on behalf of the Corporation, the contractor cannot rely on the agent’s own representation as to his actual authority. He can rely only on a representation by a person or persons who have actual authority to manage or conduct that part of the business of the corporation to which the contract relates. The commonest form of representation by a principal creating an “apparent” authority of an agent is by conduct, viz., by permitting the agent to act in the management or conduct of the principal’s business. Thus, if in the case of a company the board of directors who have “actual” authority under the memorandum and articles of association to manage the company’s business permit the agent to act in the management or conduct of the company’s business, they thereby represent to all persons dealing with such agent that he has authority to enter on behalf of the corporation into contracts of a kind which an agent authorised to do acts of the kind which he is in fact permitted to do normally enters into in the ordinary course of such business. The making of such a representation is itself an act of management of the company’s business. *Prima facie* it falls within the “actual” authority of the board of directors, and unless the memorandum or articles of the company either make such a contract *ultra vires* the company or prohibit the delegation of such authority to the agent, the company is estopped from denying to anyone who has entered into a contract with the agent in reliance on such “apparent” authority that the agent had authority to contract on behalf of the company.

In each of the relevant cases the representation relied on as creating the “apparent” authority of the agent was by conduct in permitting the agent to act in the management and conduct of part of the business of the company. Except in ***Mahony* v. *East Holyford Mining Co., Ltd.,*** the conduct relied on was that of the board of directors in so permitting the agent to act. As they had, in each case, by the articles of association of the company full “actual” authority to manage its business, they had “actual” authority to make representations in

connexion with the management of its business, including representations as to who were agents authorised to enter into contracts on the company's behalf. The agent himself has no "actual" authority to enter into the contract, because there had not been compliance with the formalities prescribed by the articles for conferring it on him. In ***British Thomson-Houston Co., Ltd.*** **v.** ***Federated European Bank, Ltd****.* [(1932) All ER Rep. 448]. Where a guarantee was executed by a single director, it was contended that a provision in the articles, requiring a guarantee to be executed by two directors, deprived the company of capacity to delegate to a single director authority to execute a guarantee on behalf of the company, i.e., that condition (d) *ante* was not fulfilled; but it was held that other provisions in the articles empowered the board to delegate the power of executing guarantees to one of their number, and this defence accordingly failed.

In the present case the findings of fact by the county court judge are sufficient to satisfy the four conditions, and thus to establish that the second defendant had "apparent" authority to enter into countracts on behalf of the defendant company for their services in connexion with the sale of the company's property, including the obtaining of development permission with respect to its use. The judge found that the board knew that the second defendant had throughout been acting as managing director in employing agents and taking other steps to find a purchaser. They permitted him to do so, and by such conduct represented that he had authority to enter into contracts of a kind which a managing director or an executive director responsible for finding a purchaser would in the normal course be authorized to enter into on behalf of the defendant company. Condition (a) was thus fulfilled. The articles of association conferred full powers of management on the board. Condition (b) was thus fulfilled. The plaintiffs, finding the second defendant acting in relation to the defendant company's property as he was authorized by the board to act, were indueed to believe that he was authorised by the defendant company to enter into contracts on behalf of the company for their services in connexion with the sale of the company's property, including the obtaining of development permission with respect to its use. Condition (c) was thus fulfilled. The articles of association, which contained powers for the board to delegate any of the functions of management to a managing director or to a single director, did not deprive the company of capactity to delegate authority to the second defendant, a director, to enter into contracts of that kind on behalf of the company. Condtion (d) was thus fulfilled. I think that the judgement was right, and would dismiss the appeal.

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Kotla Venkataswamy **v.** *Chinta Ramamurthy*

AIR 1934 Mad. 579

CURGENVEN, J. – The plaintiff, who appeals, sued to enforce a mortgage bond for Rs. 1,000 purporting to have been executed on behalf of a company calling itself the South Indian Agricultural and Industrial Improvement Co. Ltd., to one Venkatamma, who assigned her interest to the plaintiff. The company subsequently went into voluntary liquidation and the mortgaged property was sold and eventually purchased by defendant 4. The mortgage deed was signed by the Working Director and by the Secretary to the Company (defendants 1 and 2). The plaint avers that the

> "debt was regularly contracted in accordance with the powers and authority possessed by the said director and secretary under the articles of the said company and the special resolutions passed from time to time."

Defendant 4 in his written statement says that he does not admit that the document was executed by and on behalf of the company, defendants 1 and 2 not being competent to contract loans, much less to charge the property of the company. Objection is taken to the form of this statement, the contention being that it is not enough to say that a fact is not admitted in order to put the plaintiff to the proof of it and an English case ***Rutter* v. *Tregent*** [12 Ch.D. 758] is cited. But I have not been shown what are the terms of the rule which was in question in that case, and it is clear that O. 8, R. 5, C.P.C. provides for the traversal of a statement in the plaint in this form. There is a decision to this effect in ***Rajagopalachariar* v. *Bhashyachariar*** [1924 Mad. 838].

The main point in dispute is whether the mortgage bond was validly executed so as to make the company liable. Both the Courts below have answered this in the negative. It has been sought to raise two further questions here assuming that it was not so valid. It is said in the first place that the company subsequently ratified the instrument and secondly, that if the money was applied to the company's purposes the creditor would have an equitable charge for the debt upon the company's property. Neither of these two matters was made the subject of an issue at the trial. The additional Subordinate Judge, as he says at the end of the para 9 of his judgment, thought that he was concerned only with the validity and the binding nature of the mortgage deed, and although some traces of these alternative positions are to be found in the plaint, it is clear that no issues were sought in regard to them. Whether or not the subsequent action of the company amounted to ratification is clearly a question of fact. It is also a question of fact whether defendant took a sale of the property in such circumstances as would qualify the plaintiff to take advantage as against him of any equitable charge which might exist over it. Since no satisfactory explanation is forthcoming for the failure to bring these questions to trial, I do not feel justified in entertaining them in second appeal. Art. 15 of the Company's Articles of Association provides as follows:

> "All deeds, hundies, cheques, certificates and other instruments shall be signed by the Managing Director, the Secretary and the working Director on behalf of the Company, and shall be considered valid."

The suit document, as has been said is signed only by the Secretary and the Working Director, and not also by the Managing Director. It is said, but not very satisfactorily proved,

that the Managing Director had been dismissed and was under prosecution on a criminal charge at the time the document was executed. The mortgage in fact recites that part of the money was wanted for the costs of this case. The mere fact however that the services of the Managing Director were no longer available to the Company will not make execution by the remaining officers any the more valid. It is suggested that this requirement in the Articles of Association relates only to the formal process of signing and not to the power of sanctioning exercisable on behalf of the company. I do not agree with this. In the absence of any specific provision, S. 67, Companies Act then in force (6 of 1882) provides that a

> "contract by law required to be in writing signed by the parties may be made on behalf of the company in writing signed by any person acting under the express or implied authority of the company."

and R. (55) of the rules framed under the Act for regulation of a limited company (applicable in the absence of specific rules made by the company itself) vests such a power in the directors. Unless therefore Art. 15 is intended to authorize the three officers named to execute deeds on behalf of the company that power must reside only in the body of directors as a whole. I have no doubt therefore that the Secretary and the Working Director by themselves were not legally competent to execute the mortgage deed. Some attempt appears to have been made to show that the company had specially authorized these two officers to borrow money, but the learned District Judge has found this not proved and this finding being one of fact is final.

It is further argued that even if the execution of the bond was marked by irregularity, yet the mortgagee is entitled to enforce it upon the general principle that there was every reason to believe that the officers who executed it had authority to do so. This point has been discussed by the learned District Judge and I think the view which he has taken of the law is correct. There are undoubtedly cases in which the principle just referred to has been recognized, the leading case being ***Royal British Bank* v. *Turquand*** [119 E.R. 474]. In that case as between the directors and the share-holders the directors exceeded their authority, but this was not known to the plaintiffs and no illegality appeared on the face of the bond, nor were the share-holders prejudiced. If an illegality does appear on the face of the bond, the plaintiff will not be thus protected. He must be taken to have read the Companies Act and the Articles of Association of the company he is dealing with, and thus to have had constructive notice of their contents.

Now it is evident in the present case that if the mortgagee had so informed herself she would have discovered that a deed such as she took requires execution by the three specified officers of the company and she would have refrained from advancing her money upon a bond executed as is the suit bond. In place of the vague recital of authority which the mortgage bond contains reference would properly have been made to the article empowering the signatories to act in this respect. Notwithstanding therefore that the mortgagee may have acted in good faith and that her money may have been applied to the purposes of the company I find it impossible to differ from the view taken that the bond is nevertheless invalid, and that the plaintiff cannot recover upon it, and since this is the only substantial issue which was properly tried, the only course was, I think, to dismiss the suit. The second appeal is dismissed with costs of respondent 4. The memo of objections is dismissed.

Dehradun-Mussoorie Electric Tramway Co. v. Jagmandar Das and Others

AIR 1932 All 141

BANERJI and **KING, JJ.:-** This is a defendant's appeal arising out of a suit for sale upon the basis of a mortgage. The defendant is the Dehradun Mussoorie Electric Tramway Company, Limited (in liquidation). This company was incorporated about the end of August, 1921, having a registered office at Dehradun. The plaintiffs are the proprietors of a Bank at Dehradun and the company had an account with that Bank. On the 19th of January, 1923, the plaintiffs allowed the company, at the request of their managing agent Mr. Beltie Shah Gilani, an overdraft of Rs. 25,000. The mortgage deed in suit was executed on the 19th of June, 1923, by Mr. Bertie Shah on behalf of the company in favour of the plaintiffs to secure the overdraft. The defendants admit receipt of the consideration by the company. The overdraft of Rs. 25,000 was undoubtedly utilised for the necessary purposes of the company. The defendants have no objection to treating the plaintiffs as unsecured creditors, but plead that the company is not bound by the mortgage deed for various reasons which we shall have to consider in detail. The trial court held that the mortgage was valid and binding upon the company and decreed the plaintiffs' suit. The defendants in appeal have pressed the same points that were taken in the court below in support of their contention that the mortgage deed is not valid and binding upon the company.

2. The first question is whether Mr. Beltie Shah had authority to borrow Rs. 25,000 from the plaintiffs on behalf of the company. This question formed the subject of the first issue in the trial court.

3. The Board of Directors undoubtedly had power under the Articles of Association to borrow money for the purposes of the company and to secure tnhe loan by a mortgage. The appellants rely upon article 104 of the Articles of Association which lays down that “The Board may delegate any of their powers, other than powers to borrow and make calls, to Committees consisting of such member or members of their body as they, think fit.”

4. Under this article the Board are expressly prohibited from delegating their power to borrow money. Under article 120 the managing agent was given very extensive powers to conduct and manage the business and affairs of the company and he was given power “to enter into all

contracts and do all other things usual, necessary or desirable in the management of the affairs of the company".

5. The respondents contend that the power of entering into contracts would include the power of contracting loans. In our opinion, however, this contention cannot be accepted. The articles must be read as a whole and as article 104 restricts the Board from delegating its powers of borrowing, we think that article 120 could not be interpreted so as to give the managing agent unrestricted powers of borrowing money on behalf of the company. It is open to question, however, whether under the ordinary rules of law relating to agency the managing agent should not be held to have been authorised to obtain the overdraft in the circumstances of this case. The loan was urgently required for the purposes of the company. Machinery and stores had been ordered and had arrived from England and had to be paid for without delay. Under sections 188 and 189 of the Indian Contract Act an agent has very extensive powers in an emergency to do such acts as are necessary for the purpose of protecting his principal from loss and for carrying on the business. Under article 120 of the Articles of Association also the managing agent was given extensive powers to do anything necessary in the management of the affairs of the company. In the circumstances of this case the managing agent might well be regarded as being faced with an emergency and thus authorised under the ordinary rules of agency to obtain temporary accommodation from the bank for the purpose of protecting the interests of the company. It is not denied that the loan was necessary and that the money was at once utilised for the purposes of the company. We think that although the managing agent had no general power to borrow money on behalf of the company he was nevertheless authorised to incur a temporary loan in the interests of the company in an emergency such as arose in the present case. Article 104 prohibits the delegation of a general power of borrowing but we think it does not prohibit the managing agent from incurring a temporary loan in an emergency, for protecting the interests of the company.

6. Even if Mr. Beltie Shah acted *ultra vires* in obtaining this loan, it appears that his action was clearly ratified by the Board of Directors. We cannot lay stress upon the resolution which purports to have been passed, at a meeting of the Board on the 2nd of June, 1923, as it appears to us (for reasons which we shall presently give) that this resolution was not passed by a properly convened meeting of the Board. The Directors' reports to the shareholders for the

period ending the 31st of March, 1923, submitting the audited accounts for that period, shows the item of Rs. 24,454-3-8 as due to Bhagwan Das and Company (the plaintiffs) as an unsecured loan. This report purports to be signed by four of the Directors of the company at a meeting dated the 17th of September, 1923, and it has not been argued that this meeting was not properly convened. We take it, therefore, that the Board of Directors clearly ratified the loan to the plaintiffs in their report dated the 17th of September, 1923.

7. Similarly the Directors' report for the period ending the 31st of March, 1924, was signed by the Directors on the 7th of January, 1925. This report submitted the audited accounts of the company and the accounts clearly show a sum of Rs. 26,802-7-3 as due to Bhagwan Das and Company secured by charge over the company's lands. Even if Mr. Beltie Shah exceeded his powers in obtaining the loan to meet an emergency his action was never repudiated, but on the contrary was clearly ratified by the Board of Directors; so we hold that the company cannot escape liability on the ground that their managing agent had no authority to raise the loan.

8. The second question is whether the mortgage deed was executed in such a manner as to bind the company under the provisions of Company law.

9. The mortgage deed was signed by Mr. Beltie Shah in his capacity as managing agent of the company and it bears the common seal of the company. The appellants refer to article 98(*t*) of the Articles of Association and argue that the execution of the mortgage deed is invalid because under article 98(*t*) a document to which the common seal is affixed must also be signed by at least one Director and countersigned by the agent or other officer appointed by the Board for that purpose. Mr. Beltie Shah is an ex-officio Director as well as managing agent, but it is clear that, even if he be considered to have signed the document in his capacity as Director, article 98(*t*) requires countersignature by the agent or some other officer duly appointed and the document in question bears no countersignature.

10. The respondent contends that there was no necessity for affixing the common seal to the mortgage deed and the presence of the seal may be ignored. In our opinion the affixation of the seal was not required by Company law. Under section 88 of the Companies Act the mortgage could be validly executed by any person acting under the authority of the company.

No rule of law applicable to companies in general, or to this company in particular, has been shown to us requiring a deed of mortgage to be executed on behalf of a company by affixation of the common seal. If a document under seal is not necessary, then a mere defect in the manner of affixing the seal will not render the document invalid. This was the view taken by the Calcutta High Court in *Prabodhchandra Mitra* v. *Road Oils (India) Ltd.* A.I.R. 1930 Cal. 782. Their Lordships held that a mere defect in respect of the seal does not make the document for all purposes bad, even if it was intended to be under seal.

11. The next question is whether Mr. Beltie Shah was authorised to execute the mortgage on behalf of the company.

12. The minute book of the company (page 121 of the printed record) sets forth a resolution which purports to have been passed by the Directors of the company at a meeting held on the 2nd of June, 1923, in these terms: "Resolved that the Board of Directors of the Dehradun Mussoorie Electric Tramway Company, Limited, approve of the proposal of the managing agents to the effect that in order to secure the overdraft of Rs. 25,000 obtained by the company from Messrs Bhagwan Das and Company, Bankers at Dehradun, the company's land known as the Khazanchi Bagh near the Dehradun railway station be legally assigned to the said Messrs Bhagwan Das and Company on such terms and conditions as may be settled between the managing agents and Messrs Bhagwan Das and Company. The Board of Directors authorise Mr. Beltie Shah to enter into the agreement and give, the necessary deed to Messrs Bhagwan Das and Company, and to sign and seal and deliver the deed on behalf of the Board."

13. This resolution purports to be signed by three directors, namely Bakhshish Singh, B.N. Sen and Beltie Shah.

14. It has been strenuously contended for the appellant that this is a mere bogus resolution as no meeting of directors was in fact held on 2nd June 1923 and even if some directors did meet together it was not a properly convened meeting in accordance with the procedure laid down in the Articles of Association. It has been argued for the respondent that it is not open to the defendant on the pleadings to argue that no meeting took place. Para. 16 of the additional pleas at page 6 states:

That the directors' meeting referred to in para. 7 of the plaint was not properly convened inasmuch as due notice had not been given to all the directors and a ratification, if any, by any such improperly convened meeting cannot legally bind the company.

15. We think there is much force in this objection. The defendants did not deny that a meeting took place but they alleged that the meeting had not been properly convene as due notice has not been given to all the directors. On these pleadings we think it was only open to the defendant to contend and establish the fact that the meeting had not been properly convened and therefore any resolution passed by such a meeting was not legally binding upon the company. If the fact of a meeting had been expressly challenged then the plaintiff might have called evidence to prove that in fact a meeting did take place. The defendant did not call any director to prove that no meeting took place as alleged. The question however does not appear to be of much importance since if the meeting of directors had not been properly convened, after due notice, its proceedings would not have been valid and binding upon the company. No trace has been found of any notice convening a meeting on 2nd June 1923 nor is there any trace of the agenda of any such meeting.' From the letter Ex. E. p. 127, dated 7th June 1923 from Mr. Beltie Shah to Mr. Sen, one of the directors, it appears that al' though M. Beltie Shah, Mr. Narsingh Rao and Mr. Sen might have met together on 2nd June 1923 they did not in fact pass the resolution which appears in the company's minute book on that date. The letter of 7th June states the fact of the overdraft having been obtained from Messrs. Bhagwan Das & Co., who were pressing for repayment and wanting security. Mr. Beltie Shah enclosed a draft resolution (to the same effect as the resolution appearing in the company's minute book on 2nd June 1923) asking Mr. Sen to sign it and to get it signed by Mr. Rao and Sardar Bakhshish Singh. In view of this letter we think it is clear that there could not have been a properly convened meeting of directors on 2nd June 1923 which passed the resolution set forth above.

16. The next question is whether the plaintiff knew that there could have been no properly convened meeting of Directors on the 2nd of June, which passed the resolution mentioned.

17. The appellant contends that the plaintiff Jagmandar Das knew perfectly well that no meeting had been held on 2nd June and that the resolution was a mere bogus resolution. He relies mainly on the letters Ex. Q and Ex. CC. Ex Q (p. 135) is a letter from Mr. Beltie Shah

to the plaintiff dated 12th June 1923 Mr. Beltie Shah complains that the plaintiff is unreasonably impatient to" obtain security for his loan and states that the company are doing everything in their power to meet the plaintiff's wishes and adds:

You are perfectly well aware of the fact that in the case of a limited company the procedure laid down by the Articles and law has to be gone through and the delay is only natural as all our directors are nonresidents of Dehra Dun.

18. The appellant argues that the plaintiff on receiving this letter must have known that no resolution sanctioning the execution of a mortgage to secure the overdraft could have been passed by a meeting of directors on 2nd June. Ex. CO (p.139) is a letter dated 16th June 1923 from the plaintiff to Mr. Beltie Shah. The plaintiff complains of the delay in adjusting the overdraft or giving security for it and says:

Till now you ought to have got the matter settled by the directors by means of correspondence.

19. This is interpreted by the appellant as showing that the plaintiff knew that no resolution sanctioning the mortgage had been passed on 2nd June but he hoped that the business would be settled by means of correspondence. For the respondent it is contended that although no resolution may have been passed at a properly convened meeting of directors on 2nd June the plaintiff was not aware of that fact. Ex. HH (p. 117), which is a letter written by the plaintiff to Mr. Beltie Shah on 26th May 1923, shows that there was a talk about giving security for the overdraft from about 25th May. It was possible therefore for the managing agent to have given one week's notice of a meeting to the directors before 2nd June. Ex. Q does not show for certain that no resolution was passed on 2nd June nor does Ex. CC show for certain that the plaintiff knew that no resolution could have been passed on 2nd June. Buggan Lal, manager of the plaintiff's bank, deposed that Mr. Beltie Shah had shown him the minute book of the company, containing the resolution of 2nd June, a day or two before the execution of the deed i.e., on 18th June. The question was expressly put to him that when he knew from the letter of 12th June (Ex. Q) that Beltie Shah had spoken of the necessity of sanction by the directors why did he not suspect Mr. Beltie Shah of being a tricky and unreliable man when

he showed the witness a resolution purporting to have been passed on 2nd June. The'witness answered:

I took him to be extra honest because he had frankly shown me the minute book of the company and because he had said that money, was being expected from Nabha every day.

20. In all the circumstances of this case we think it was very possible that Buggan Lal and the plaintiff were deceived by Mr. Beltie Shah. One must remember that in June, 1923, there was no suspicion that the company would go into liquidation and the plaintiff had no reason to suspect Mr. Beltie Shah of being a tricky and unreliable man. Subsequent events have no doubt cast a lurid light upon his character and methods and in the light of such subsequent events it may be argued that the plaintiff and Buggan Lal ought not to have put so much trust in Mr. Beltie Shah. It is easy to be wise after the event, but in the circumstances we think that Mr. Beltie Shah who appears to have been a very capable and plausible man persuaded the plaintiff that the execution of the mortgage had really been sanctioned by a properly convened meeting of the Directors. Buggan Lal and the plaintiff may have thought it strange that Mr. Beltie Shah did not refer to the resolution in his letter of the 12th of June, but he seems to have explained to them that he was in daily expectation of receiving large sums of money from Nabha out of which he could repay the overdraft, thus rendering the execution of a mortgage deed unnecessary, and therefore he made no previous mention of the resolution sanctioning the mortgage. However this may be, when Mr. Beltie Shah showed Buggan Lal the minute book of the company containing the resolution signed by three of the Directors, as we believe he did, we think it would have been difficult for Buggan Lal to disbelieve the representation that the resolution had been duly passed. Moreover, the conduct of the plaintiff in accepting the mortgage supports the view that he believed that the execution of the mortgage had been sanctioned by the Board of Directors. The plaintiff would not have been likely to accept a mortgage which to his knowledge had not been sanctioned by the Directors and was not binding upon the company. If the plaintiff had known or even strongly suspected that the mortgage had not been sanctioned he would not have accepted it but would have sued the company for recovery of the loan.

21. It has further been argued for the appellant that the Directors were not authorised under the Articles of Association to empower Mr. Beltie Shah to execute the mortgage. The

argument is that, as the Directors cannot delegate their power to borrow they could not leave the details of the mortgage transaction to be settled by the managing agent. The reply to this is that the loan had already been incurred and there was no question of delegating the power of borrowing any further sums. The only question for the Directors was whether they should give the plaintiff a security for the loan which he had already advanced. Under article 104 we think the Board could legally empower one of the Directors to execute the mortgage deed on their behalf and to settle the details of the mortgage transaction.

22. The result is that in our opinion the Board of Directors could legally authorise Mr. Beltie Shah to execute the mortgage on behalf of the company by a resolution passed at a properly convened meeting. As a matter of fact we hold that there was no properly convened meeting which passed the resolution dated the 2nd of June, but the plaintiff had no reason to suppose that the resolution had not been properly passed and was not binding upon the company. On these facts we consider that the plaintiff is protected in spite of the defect in passing the resolution, and the company is bound by the mortgage so far as Company law is concerned. The law on this point is laid down in Halsbury's "*Laws of England*", volume 5, page 302, as follows: "The persons contracting with a company and dealing in good faith may assume that acts within the power of the company have been properly and duly performed and are not bound to enquire whether acts of internal management have been regular."

23. The case of the *Royal British Bank* v. *Turquand* [1856] 6 Ellis. & Bl. 327 is one of the most important cases on this point. In that case the Directors of the company were authorised in certain circumstances to give bonds, but the company sought to escape liability on the ground that there had been no resolution authorising the making of the bond in suit. It was held that the plaintiff was entitled to judgment, having a right to presume that there had been a resolution at a general meeting authorising the borrowing of the money on the bond.

24. For an Indian decision on this point we may refer to the case of *Ram Baran Singh* v. *Mufassil Bank Limited* A.I.R. 1925 All. 206 in which it was held that a company is liable for all acts done by its Directors, even though unauthorised by it, provided such acts are within the apparent authority of the Directors and not *ultra vires* the company. Persons dealing *bona fide* with a Managing Director are entitled

to assume that he has all such, powers as he purports to exercise if they are powers which according to the constitution of the company a Managing Director can have.

25. We agree with the court below, therefore, in finding that the company is bound by the mortgage so far as Company law is concerned.

26. The next question is whether the mortgage is void for want of previous sanction by the Local Government. Under clause 37 of the Dehradun Mussoorie Tramway Order, 1921, it is laid down that "the promoter shall have power to transfer the undertaking with the assent of Government previously obtained, but not otherwise, to any person or persons or to a company."

27. It is argued that as the Local Government did not give their previous assent to the mortgage it is void.

28. The respondent replies that the defendant has never proved that the mortgage was made without the previous sanction of the Local Government, a fact which was within the defendant's special knowledge. In our opinion there is no force in this reply. Issue 3 at p. 20 implies that the mortgage had not been sanctioned by the Local Government. The plaintiff never alleged that such sanction had been obtained. In our opinion the Court below wrongly cast the onus upon the defendant of proving that in fact no sanction had been obtained for the mortgage. The plaintiff himself admits in cross-examination that so far as he is aware no permission or sanction was taken from the Government for the execution of the mortgage-deed; he did not know that any such sanction was necessary, nor did Beltie Shah ever tell him that any such sanction had been obtained. In view of the plaintiff's admissions and in view of the fact that he never alleged that sanction had been obtained and allowed the issue to be framed in such a manner as to imply the absence of sanction we consider that it must be held that the mortgage was executed without previous sanction by the Local Government. The question, however, remains whether the mortgage is void on that account and this raises several points for determination. The first question is whether the company was a. "promoter" within the meaning of the Indian Tramways 5 Act, 1886, and the Tramway Order of 1921, made under sub-section (3) of section 6 of that Act by the Local Government. "Promoter" is defined in the Act as meaning a local authority or person in whose favour an order has been

made and includes a local authority or person on whom the rights and liabilities conferred and imposed on the promoter by this Act and by the Order and any rules made under this Act as to the construction, maintenance and use of the Tramway have devolved. Beltie Shah was undoubtedly a “promoter” and is expressly referred to as the promoter in the Tramway Order. The question is whether the rights and liabilities conferred and imposed upon him have legally devolved upon the company.

29. It is argued for the respondent that they have not legally devolved upon the company because the Local Government did not give their previous consent to the transfer of the undertaking by Beltie Shah to the company. On 22nd December 1921 an agreement was entered into between Beltie Shah and the company (Ex. H,P.53) whereby the company agreed to take over the benefit and liability of Beltie Shah under the tramway order. It was argued that there was no proof of any previous sanction of this transfer and therefore it was void and the company never became a "promoter" and was not subject to the conditions laid down in the tramway order. By consent of parties we allowed the appellant to file further evidence on the question of the Local Government's sanction of the transfer of the undertaking by Beltie Shah to the company. It appears that on 27th May 1921 Mr. Beltie Shah first submitted his formal application for permission to transfer the undertaking to a company. This application was made before the concession had been granted to him. On 28th June 1921 Mr. Beltie Shah, writing to Mr. Willmott, the Chief Engineer and Secretary to Government in the Public Works Department, admits that strictly speaking he has not yet received the concession and therefore he will content himself with a letter from Mr. Willmott to the effect that he will have no objection to permit the transfer of the proposed concession for constructing the tramway. He further says it must be understood that this tentative permission is merely to facilitate the incorporation of the company under the Companies Act. Mr. Willmott replies by a letter dated 9th July 1921:

As regards the request made in para 6 of your letter I have to say that if the provisional order becomes valid Government will have no objection to the transfer.

30. After the tramway order had become absolute Mr. Beltie Shah wrote again to Mr. Willmott on 10th January 1922 referring to the previous letter (saying that Government will have no objection to the transfer) and asking that official permission for the transfer shall now

be given. By a letter dated 22nd February 1922 the-formal sanction of the Local Government to the transfer of the order, authorizing: the construction of a tramway, was conveyed to Mr. Beltie Shah.

31. For the respondent it is argued that as formal sanction for the transfer was only accorded on the 22nd of February, 1922, the transfer effected by the agreement of the 22nd of December, 1921, was void since there was no previous sanction. The appellant maintains that the letter of the 9th July, 1921, intimating that Government will have no objection to the transfer is sufficient authority for the transfer. In our opinion the appellant's contention is correct. The Tramway Order merely lays down in clause 37 that the undertaking can only be transferred with the assent of Government previously obtained, but does not specify any form in which such assent should be expressed. In our opinion a demi-official letter such as that of the 9th of July, 1921, by a Secretary to Government in the Public Works Department, intimating that Government will have no objection to the transfer is sufficient to convey the previous assent of Government. We take it therefore that the company did become a "promoter" in place of Beltie Shah.

32. The next question is whether the land mortgaged formed part of the "undertaking". The land was bought by the company on the 15th of May, 1922, for the purpose of a tramway depot, that is, for administrative offices and a car shed. "Undertaking" is defined as including all movable and immovable property of the promoter suitable to and used by him for the purposes of the tramway. The fact that the land near the railway station was "suitable" for the purposes of the tramway can hardly be disputed. It was obviously necessary that the Tramway Company should have some administrative offices and a car shed, and a site near the railway station was obviously suitable. It is argued, however, that at the time of the mortgage the property was not used by the company for the purposes of the tramway. The evidence shows that at that time some sleepers, intended for the construction of the tramway, were stacked upon the land. In our opinion this indicates use of the land for the purposes of the tramway sufficient to bring it within the definition of "undertaking". The mere fact that the land was not acquired under the Land Acquisition Act or with the concurrence of the Superintendent of the Doon, as laid down in clause 13 of the Tramway Order, will not take the land out of the category of "undertaking". Undoubtedly the land was acquired for the purpose of the tramway

and the method of its acquisition is immaterial for the purpose of deciding whether it is part of the company's undertaking. We find that it is part of the "undertaking" because it belonged to the company and was suitable for and used by the company for the purposes of the tramway.

33. The mortgage, then, was made in contravention of clause 37 of the Tramway Orders as having been made without the previous assent of Government. On these facts the respondent argues that the transfer would only be voidable at the option of the Local Government and not absolutely void. The appellant maintains that the mortgage is absolutely void and in our opinion his contention is well founded. The rules laid down in the Tramway Order have the force of law and in our opinion the transfer of part of the undertaking without the previous sanction of Government must be held to be absolutely void. In the case of *Gaurishankar Balmukund* v. *Chinnumiya* A.I.R. 1918 P.C. 168 it was held by their Lordships of the Privy Council that a mortgage by a judgment-debtor in contravention of paragraph 11 of the third schedule of the Code of Civil Procedure is void and not merely voidable. We may also refer to the rulings in *Dipan Rai* v. *Ram Khelawan* [1910] 32 All. 383, and *Har Prasad Tiwari* v. *Sheo Gobind Tiwari* A.I.R. 1922 All. 134 in which the mortgage of an occupancy holding in contravention of the Agra Tenancy Act was held to be void. In our opinion the same principles would apply to a mortgage in contravention of a clause of the Tramway Order. If the mortgage is void it cannot be ratified nor can it be pleaded that the defendant is estopped from denying his competence to create the mortgage. We hold, therefore, that the mortgage is void.

34. The appellants being the Liquidators of the Dehradun Mussoorie Electric Tramway Company and all the evidence having been taken in this case, we think that instead of the plaintiffs proving their claim in the course of the liquidation proceedings they should be given a decree for money as against the Liquidators. They will thus rank as unsecured creditors and will get their money in due course of liquidation.

35. We allow the appeal and vary the decree of the trial court by granting to the plaintiffs a simple money decree for Rs. 29,773-4-3 to be realised by them in due course of liquidation. Interest at the contractual rate, will cease as from the 29th of January, 1926. If there are any surplus assets interest at 6 per cent, per annum, will be payable out of the surplus up to the

date of repayment. The appellants will get half the costs of this appeal and those in the court below from the respondents. The respondents will bear their own costs.

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DIRECTORS – DUTIES AND LIABILITIES

Percival v. *Wright*

(1902) 2 Ch. 421

The directors of a company are not trustees for individual shareholders, and may purchase their shares without disclosing pending negotiations for the sale of the company's undertaking.

This was an action to set aside a sale of shares in a limited company, on the ground that the purchasers, being directors, ought to have informed their vendor shareholders of certain pending negotiations for the sale of the company's undertaking.

In and on prior to October 1900, the plaintiffs were the joint registered owners of 253 shares of 10*l*. each (with 9*l.* 8*s*. paid up) in a colliery company called Nixon's Navigation Company, Limited.

The objects of the company, as defined by the memorandum of association, included the disposal by sale of all or any of the property of the company. The board of directors was empowered to exercise all powers not declared to be exercisable by general meetings; but no sale of the company's collieries could be made without the sanction of a special resolution.

The shares of the company, which were in few hands and were transferable only with the approval of the board of directors, had no market price and were not quoted on the Stock Exchange. On October 8, 1900, the plaintiffs' solicitors wrote to the secretary of the company asking if he knew of any one disposed to purchase shares. On October 15, 1900, in answer to the secretary's inquiry as to what price they were prepared to accept, the plaintiffs' solicitors wrote stating that the plaintiffs would be disposed to entertain offers of 12*l*. 5*s.* per share. This price was based on a valuation which the plaintiffs had obtained from independent valuers some months previously. On October 17, 1900, the chairman of the company wrote to the plaintiffs' solicitors stating that their letter of October 15 had been handed to him, and that he would take the shares at 12*l*. 5*s*. On October 20, 1900, the plaintiffs' solicitors having taken a fresh valuation, replied that the plaintiffs were prepared to accept 12*l*. 10*s*. per share. On October 22, 1900, the chairman wrote accepting that offer, and stating that the shares would be divided into three lots. On October 24, 1900, the chairman wrote stating that eighty-five shares were to be transferred to himself and eighty-four shares apiece to two other named directors. The transfers having been approved by the board, the transaction was completed.

The plaintiffs subsequently discovered that, prior to and during their own negotiations for sale, the chairman and the board were being approached by one Holden with a view to the purchase of the entire undertaking of the company, which Holden wished to resell at a profit to a new company. Various prices were successively suggested by Holden, all of which represented considerably over 12*l*. 10*s*. per share; but no firm offer was ever made which the board could lay before the shareholders, and the negotiations ultimately proved abortive. The Court was not in fact satisfied on the evidence that the board ever intended to sell.

The plaintiffs brought this action against the chairman and the two other purchasing directors, asking to have the sale set aside on the ground that the defendants as directors ought to have disclosed the negotiations with Holden when treating for the purchase of the plaintiffs' shares.

For the plaintiffs. There is no suggestion of unfair dealing or purchase at an undervalue; but the defendants as directors were in a fiduciary position towards the plaintiffs, and ought to have disclosed the negotiations for sale of the undertaking, in which case the plaintiffs would have retained their shares, on the chance of that sale going through.

The prima facie obligation of directors purchasing shares to disclose all information as to the shares is, no doubt, tacitly released as to information acquired in the ordinary course of management. The defendants, for instance, would not have been bound to disclose a large casual profit, the discovery of a new vein, or the prospect of a good dividend. But that release did not relive them from disclosing the special information acquired during their negotiations for the sale of the entire undertaking. At the commencement of those negotiations they became trustees for sale for the benefit of the company and the shareholders, and could not purchase the interest of an ultimate beneficiary without disclosing those negotiations. They are trustees both for the company and for the shareholders who are the real beneficiaries. No question of privity can arise in the case of trusts.

Now, "a share in a company, like a share in a partnership, is a definite proportion of the joint estate, after if has been turned into money, and applied as far as may be necessary in payment of the joint debts": Lindley on Companies, 5th ed. p.449.

The undertaking of the company is, therefore, merely the sum of the shares. No doubt at law it belongs to the company, but in enquiry it belongs to the shareholders and the directors as trustees for sale of the undertaking cannot purchase the interest of a beneficiary without giving him full information. In this respect the shareholders inter se are in the same position as partners, or shareholders in an unincorporated company. If managing partners employ an agent to sell their business, he cannot purchase the share of a sleeping partner without disclosing the fact of his employment. Incorporation cannot affect this broad equitable principle. It does not alter the rights of the shareholders inter se, though it affects their relations to the external world.

In the present case the plaintiffs knew that the directors were managing the business, but not that they were negotiating a sale of the undertaking, and the non-disclosure of the latter fact entitles them to set aside the sale of their shares.

For the defendants. Even if the directors were trustees for sale of the undertaking, they were not trustees for sale of the plaintiffs; shares. They suggested equity has never been applied between a director and a shareholder, although a director purchasing shares must always purchase from a shareholder. The company is a legal entity quite distinct from the shareholders, so that a sale by a mortgagee to a company in which he is a shareholder is neither in form or substance a sale to himself and a sale by a company to a shareholder cannot be impeached on the ground that the resolution authorizing that sale was carried by the votes of that shareholder. The principle underlying these decisions is quite inconsistent with the plaintiffs' contention.

SWINFEN EADY J. – The position of the directors of a company has often been considered and explained by many eminent equity judges. In ***Great Eastern Ry. Co.* v. *Turner*** [(1872) L.R. 8 Ch. 149, 152] Lord Selborne L.C. points out the twofold position which directors fill. He says: "The directors are the mere trustees or agents of the company – trustees of the company's money and property –agents in the transactions which they enter into on behalf of the company." In ***In re Forest of Dean Coal Mining Co.*** [(1878) 10 ChD 450, 453] Jessel M.R. says: "Again, directors are called trustees. They are no doubt trustees of assets which have come into their hands, or which are under their control, but they are not trustees of a debt due to the company. The company is the creditor, and, as I said before, they are only the managing partners." Again, in ***In re Lands Allotment Co.*** [(1894) 1 Ch. 616, 631], Lindley L.J. says: "Although directors are not properly speaking trustees, yet they have always been considered and treated as trustees of money which comes to their hands or which is actually under their control; and ever since joint stock companies were invented directors have been held liable to make good moneys which they have misapplied upon the same footing as if they were trustees, and it has always been held that they are not entitled to the benefit of the old Statute of Limitations because they have committed breaches of trust, and are in respect of such moneys to be treated as trustees."

It was from this point of view that ***York and North Midland Ry. Co.* v. *Hudson*** [16 Beav. 485, 491, 496] and ***Parker* v. *McKenna*** [(1874) L.R. 10 Ch. 96] were decided. Directors must dispose of their company's shares on the best terms obtainable, and must not allot them to themselves or their friends at a lower price in order to obtain a personal benefit. They must act bona fide for the interests of the company.

The plaintiffs' contention in the present case goes far beyond this. It is urgued that the directors hold a fiduciary position as trustees for the individual shareholders, and that, where negotiations for sale of the undertaking are on foot, they are in the position of trustees for sale. The plaintiffs admitted that this fiduciary position did not stand in the way of any dealing between a director and a shareholder before the question of sale of the undertaking had arisen, but contended that as soon as that question arose the position was altered. No authority was cited for that proposition, and I am unable to adopt the view that any line should be drawn at that point. It is contended that a shareholder knows that the directors are managing the business of the company in the ordinary course of management, and impliedly releases them from any obligation to disclose any information so acquired. That is to say, a director purchasing shares need not disclose a large casual profit, the discovery of a new vein, or the prospect of a good dividend in the immediate future, and similarly a director selling shares need not disclose losses, these being merely incidents in the ordinary course of management. But it is urged that, as soon as negotiations for the sale of the undertaking are on foot, the position is altered. Why? The true rule is that a shareholder is fixed with knowledge of all the directors' powers, and has no more reason to assume that they are not negotiating a sale of the undertaking that to assume that they are not exercising any other power. It was strenuously urged that, though incorporation affected the relations of the shareholders to the external world, the company thereby becoming a distinct entity, the position of the shareholders inter se was not affected, and was the same as that of partners or shareholders in an unincorporated company. I am unable to adopt that view. I am therefore of

opinion that the purchasing directors were under no obligation to disclose to their vendor shareholders the negotiations which ultimately proved abortive. The contrary view would place directors in a most invidious position, as they could not buy or sell shares without disclosing negotiations, a premature disclosure of which might well be against the best interests of the company. I am of opinion that directors are not in that position.

There is no question of unfair dealing in this case. The directors did not approach the shareholders with the view of obtaining their shares. The shareholders approached the directors, and named the price at which they were desirous of selling. The plaintiffs' case wholly fails, and must be dismissed with costs.

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Burland v. *Earle (Consolidated)*

(1900-3) All E.R. 1452

LORD DAVEY – The appellants and respondents are alike in a joint stock company called the British American Bank Note Company. The company was incorporated on 16 June 1866 in Canada. The objects for which the company was formed were "to engrave and print banknotes, debentures, bonds, postage and bill stamps, and bills of exchange, and to carry on all other branches incidental thereto." The capital of the company was originally $100,000 divided into shares of $100 each, but was subsequently increased to $200,000, of which $170,000 only has been issued. By s. 1 of the Act provision is made for the incorporation by letters patent of companies, for the purpose *(inter alia)* of carrying on any kind of manufacturing business, and by s. 5 it was declared that every company incorporated under the Act should be subjected to the general provisions set out in subsections (1) – (34) thereof. Subsection (7) so far as material is as follows: "(7). The directors of the company shall have full power in all things to administer the affairs of the company, and may make or cause to be made for the company any description of contract which the company may by law enter into; and may from time to time make bye-laws not contrary to law, to regulate *(inter alia)* the declaration and payment of dividends, the number of directors, their term of service, the amount of their stock qualification, the appointment, functions, duties and removal of all agents, officers and servants of the company, the security to be given by them to the company, their remuneration and that (if any) of the directors, the time at which, and the place or places where the annual meetings of the company shall be conducted." The Act contains no express provisions as to the formation of a reserve fund, or as to the investment or application of the undivided profits of the company. Shortly after the formation of the company the shareholders made a number of bye-laws of which the following are material for the purpose of this litigation: "(9). The shareholders of the company may at any general meeting of the company, vote and award to the directors of the company, such compensation as they may think proper (10). "At all meetings of the company, every shareholder shall be entitled to as many votes as he may own shares in the company, and may vote by proxy; but no shareholder shall be entitled to vote unless he has paid all calls in respect of his shares. (11). The directors shall have the management of the affairs of the company, the appointment, control and removal of all the officers and employees of the company, and shall, from time to time, regulate their several duties and remuneration. (12). At every annual general meeting the directors shall present a report and abstract of the accounts of the company, a concise statement of their affairs, and a true and succint statement of their assets and liabilities; and, if they deem fit, shall recommend the declaration of a dividend of so much per cent on the stock out of the earned profits of the company; and in the interval between the annual general meetings of the company, the directors, may, at any regular meeting, declare a dividend whenever an actual cash balance in the hands of the secretary-treasurer from the earned profits of the company shall, in their judgment, warrant the payment of such dividend. (13). The directors may set apart any portion of the profits for a reserve fund, subject to the approval of a general meeting, or to the appropriation of such sum by such meeting to any other purpose. (14). The number of directors shall never be less than three, nor more than six. Every new board of directors, as soon as elected, shall elect a president and a vice-president;

they shall also elect the president or vice-president, or any director, to be at the same time manager, and if any of the places of these officers become vacant, they may be filled by the board electing others in their place. (16). At every board meeting three directors shall constitute a quorum. The president shall preside, in his absence the vice-president, and, failing both, any director. The president or chairman, as a director, shall have one vote." The company was formed by the union of two groups, one represented by the appellant George B. Burland (who is hereafter referred to as Burland), and the other by a Mr. Smillie and the respondent Earle. Mr. Smillie was the first president, and Burland and the respondent Earle were first directors. Mr. Smillie retired from the company in 1881, and sold his shares. Burland from time to time increased his holding, and at the date of the commencement of the action he held 1077 shares. He was also the president and manager of the company. The plaintiffs and respondents hold between them 433 shares. The respondent Earle continued on the board of directors (with two short intervals) until the year 1890, when he resigned. The respondent Mrs. Cunningham sues as the administratrix of James Cunningham deceased, who was at one time the auditor, and from 1887 until his death in 1892, was a director of the company. The respondent Thomas J. Gillelan was from 1892, and at the commencement of the action, a director of the company. The company's business has been extraordinarily successful. In some years it has paid to its shareholders a dividend exceeding 100 per cent, and the average of the dividends paid during the thirty years of its existence prior to the commencement of the action is said to exceed 40 per cent per annum. In addition to the dividends so paid, the company has accumulated the undivided profits to the amount at the commencement of the action of $264,167. This sum was not formally carried to the credit of a rest or reserve fund, but stood to the credit of the profit and loss account of the company. Shortly before the commencement of the action the company lost a valuable contract with the Dominion Government. The result was a serious diminution of the profits of its business. The action was commenced by the respondents on 7 December 1897. By their amended statement of claim they prayed for a declaration that the accumulation by the defendants of a surplus or reserve fund was *ultra vires,* and for an immediate division and distribution amongst the shareholders of all sums of money accumulated and retained as a reserve fund over and above the authorised capital stock of the company and various other items of relief. Their Lordships will confine their attention to the points which have been discussed on these appeals. These are (1) the formation of the rest or reserve fund; (2) the investment of it; (3) a claim by the respondents to treat Burland as a trustee of the plant and material of a certain insolvent company, called the Burland Lithographic Company, which he purchased at a sale by auction and resold at an enhanced price to this company and to make him account to the company accordingly for the profit made by the resale; (4) a question as to certain sums drawn as salaries by Burland and the appellant, J. H. Burland. It is an elementary principle of the law relating to joint stock companies that the court will not interfere with the internal management of companies acting within their powers, and in fact has no jurisdiction to do so. Again, it is clear law that in order to redress a wrong done to the company, or to recover moneys or damages alleged to be due to the company, the action should prima facie be brought by the company itself. But an exception is made to the second rule, where the persons against whom the relief is sought themselves hold and control the majority of the shares in the company, and will not permit an action to be brought in the name of the company. In that case the courts

allow the shareholders complaining to bring an action in their own names. This, however, is mere matter of procedure in order to give a remedy for a wrong which would otherwise escape redress, and it is obvious that in such an action the plaintiffs cannot have a larger right to relief than the company itself would have if it were plaintiff, and cannot complain of acts which are valid if done with the approval of the majority. The cases in which the minority can maintain such an action are therefore confined to those in which the acts complained of are of a fraudulent character, or beyond the powers of the company. A familiar example is where the majority are endeavouring directly or indirectly to appropriate to themselves money, property, or advantages which belong to the company, or in which the other shareholders are entitled to participate, as was alleged in the case of ***Menier* v. *Hooper's Telegraph Works*** [9 Ch. App. 350]. It should be added that no mere informality or irregularity which can be remedied by the majority will entitle the minority to sue it the act, when done regularly, would be within the powers of the company, and the intention of the majority of the shareholders is clear. This may be illustrated by the judgment of Mellish, L.J., in ***Macdougall* v. *Gardiner*** [1 ChD 13]. There is yet a third principle which is important for the decision of this case. Unless otherwise provided by the regulations of the company a shareholder is not debarred from voting or using his voting power to carry a resolution by the circumstance of his having a particular interest in the subject-matter of the vote. This is shown by the case before this board of the ***North-West Transportation Company Limited* v. *Beatty*** [12 AC 589]. In that case the resolution of a general meeting to purchase a vessel at the vendor's price was held to be valid notwithstanding that the vendor himself held the majority of the shares in the company, and the resolution was carried by his votes against the minority who complained. If these elementary considerations are borne in mind the solution of the principle questions arising in these appeals will not present any real difficulty. It was originally maintained by the plaintiffs that art. 13 of the bye-laws was beyond the powers of the company or (in other words) that a company formed by letters patent under the Act 27 & 28 Vict. c. 23 was bound to divide all its profits on each occasion and could not by law reserve any portion thereof either to meet contingencies, or for future division, or for any other purpose of a reserve fund. The Chief Justice who tried the action held that the company had no implied power to create a reserve fund, or, "least of all", to invest a reserve fund upon securities; but he thought the question immaterial, as the company had not, in his opinion, set apart or appropriated a reserve fund, and he held that the whole of the sum to the credit of profit and loss ought to be distributed amongst the shareholders. But, in his formal judgment or decree, he allowed the company to deduct and retain "a reasonable sum for contingencies, the amount, in case the parties differed, to be settled by the Chief Justice." In the Court of Appeal it was held that it was within the powers of the company to set apart "a fair and reasonable sum" out of the profits as a reserve fund, and it was the duty of the directors to invest it in a proper manner. But the learned judges seem to have thought that the company had not exercised the power except as to a sum of $44,022, and they held that the balance in question, after deducting that amount, was distributable amongst the shareholders. In their formal judgment the court inserted a saving for the right of the directors and shareholders to appropriate out of future profits "such further reserve fund as the needs of the company may properly require." Their Lordships are not aware of any principle which compels a joint stock company, while a going concern, to divide the whole of its profits amongst its shareholders. Whether the whole or any part should

be divided, or what portion should be divided and what portion retained, are entirely questions of internal management which the shareholders must decide for themselves, and the court has no jurisdiction to control or review their decision, or to say what is a "fair" or "reasonable" sum to retain undivided, or what reserve fund may be "properly" required. And it make no difference whether the undivided balance is retained to the credit of profit and loss account, or carried to the credit of a rest or reserve fund, or appropriated to any other use of the company. These are questions for the shareholders to decide subject to any restrictions or directions contained in the articles of association or bye-laws of the company. If the company may form a reserve fund, or retain a balance of undivided profits, it must (it would seem) have power to invest the moneys so retained. The junior counsel for the respondents contended that the company, in the absence of express power to invest, could employ the money only in its own business. This contention has no support either in principle or authority, and if it were sound the object for which a reserve fund is needed would in many cases be defeated. The business of this company affords cogent instance. In order to obtain a Government contract, it may be called upon to make a large deposit or purchase new and expensive plant. It has no power to borrow, and it had no rest or reserve fund it would have no funds out of which to make the necessary expenditure. Upon what securities, then, may the company invest its undivided profits or reserve fund? It is conceded at the Bar that the company is not confined to such investments as trustees are authorised to make. The answer, therefore, can only be that the reserve fund may lawfully be invested on such securities as the directors may select subject to the control of a general meeting. The annual accounts of the company from 1873 onwards are in evidence. They consist of a profit and loss account and a balance-sheet. These accounts were regularly placed before the general meeting. The balance-sheets show under a separate heading the investments from time to time held by the company, consisting for the most part of bank shares and mortgages. It is not for their Lordships to judge of the propriety or sufficiency of these investments. It may have been expedient for business reasons for the company to hold an interest in the various Canadian banks. The investments when made reappear in subsequent balance-sheets and seem to have been of a permanent character. There is, therefore, no ground for the suggestion that the directors were using the reserve fund for the purpose of trafficking or speculation in stocks and shares. The investments were wholly or for the most part made in the name of Burland alone. This was, for obvious reasons, unwise and imprudent, but it must have been within the knowledge of the respondent Earle, the late Mr. Cunningham, and the respondent Gillelan, and no complaint or remonstrance seems to have been made until the institution of the present suit. Burland is, of course, bound to account for all the moneys of the company which have come to his hands. Very full accounts are directed by the judgment of the Court of Appeal. There is no appeal from this portion of the judgment, and the accounts and inquiries will be prosecuted accordingly. Mr. Haldane asked for some injunction with respect to these matters, but did not make clear to their Lordships the form or extent of the injunction to which he considered that his clients were entitled. The Court of Appeal granted an injunction to restrain the appellants and the company from employing the net profits and earnings of the company already or which may hereafter be earned in the purchase of shares of the capital stocks of banks or other companies, and from using any portion of the net earnings and profits for the purpose of making loans to persons or corporations, and also an injunction to restrain the appellant

Burland from investing in his own name, or "personally controlling", any portion of the earnings or moneys of the company, or from dealing with the same otherwise than in accordance with the judgment. For the reasons which have already been given, it is clear that so sweeping an injunction against the directors and the company cannot be maintained. And it is equally clear that the injunction against Burland cannot be maintained. It is not *ultra vires* for the company, if it thinks fit to do so, to invest in the name of a sole trustee, however imprudent and undesirable such a course may be. Nor can Burland, as shareholder, manager, and president of the company, be restrained from exercising any personal control over any portion of the company's earnings, in which indeed he has the largest interest. If it appeared that under the guise of investing undivided profits or the reserve fund, the directors were, in fact, embarking the moneys of the company in speculative transactions, or otherwise abusing the powers invested in them for the management of the company's business, different considerations would of course arise. But it does not appear to their Lordships that the investments of the surplus profits in bank shares or bonds of trading companies really bears that character or was intended to be or was otherwise than a bonafide exercise of the powers of the company and the directors. The next matter to which the appeal relates is the sale to the company by the Burland of the lithographic plant, etc., of the Burland Lithographic Company. It appears that that company had been carrying on business in Montreal and, having become insolvent, was wound-up under the provisions of the Winding-up Act. Burland was interested in the company as a stock-holder and a creditor. At the public sale by the liquidator on 10 May 1892 Burland bid for and purchased all the assets of the company in four lots. The price paid by him for lot 1 was $21,564, and he shortly afterwards sold the property comprised in that lot to the appellant company for $ 60,000. The property, together with some other plant purchased from another company was subsequently sold to a company formed for the purpose at an enhanced price, payable in shares which were distributed as a bonus amongst the shareholders of the company. In these circumstances Burland has been ordered to pay to the company the sum of $38,436, being the amount of the profit realised by him on the resale. Both courts have held that the resale was by Burland's advice and influence, and was made without disclosing to the company the price at which he had purchased. It was also held in the Court of Appeal that Burland had bought the property with the intention and for the purpose of reselling it to the company. It appears from the evidence of the respondent Earle, who was then the next largest shareholder to Burland and a director, that he was present at the sale and knew all about the transaction, and from the evidence of Gillelan that he knew what Burland had paid "very shortly after." There was evidence of two witnesses, Reinhold and Monk, that the price to the company was not unfair. But their Lordships do not think it necessary to pursue these topics because they are of opinion that the relief prayed by the amended statement of claim and granted in the courts below is altogether misconceived. There is no evidence whatever of any commission or mandate to Burland to purchase on behalf of the company or that he was in any sense a trustee for the company of the purchased property. It may be that he had an intention in his own mind to resell it to the company, but it was an intention which he was at liberty to carry out or abandon at his own will. It may be also that a person of a more refined self-respect and a more generous regard for the company of which he was president would have been disposed to give the company the benefit of his purchase. But their Lordships have not to decide questions of that character. The sole question

is whether he was under any legal obligation to do so. Let it be assumed that the company or the dissentient shareholders might by appropriate proceedings have at one time obtained a decree for rescission of the contract. But that is not the relief which they ask or could in the circumstances obtain in this suit. The case seems to their Lordships to be exactly that put by Lord Cairns, L.C., in ***Erlanger* v. *New Sombrero Phosphate Company*** [1878 3 AC 1218]. In that case the bill prayed for rescission or, alternatively, for the profit made by Erlanger and his syndicate on the resale to the company. Lord Cairns said: "It may well be that the prevailing idea in their mind was not to retain or work the island but to sell it again at an increase of price and very possibly to promote or get up a company to purchase the island from them; but they were, as it seems to me, after their purchase was made, perfectly free to do with the island whatever they liked, to use it as they liked, and to sell it how and to whom and for what price they liked. The part of the case of the respondents, which, as an alternative sought to make the appellants account for the profit which they made on the resale, of the property to the respondents on an allegation that the appellants acted in a fiduciary position at the time they made the contract of 30 August 1871, is not, as I think, capable of being supported, and this, as I understand, was the view of all the judges in the courts below." Reference may also be made to the judgments of Pearson, J., and Cotton and Fry, L.J. in ***Re Cape Breton Company*** [26 Ch. D. 221]. To rescind the sale is one thing but to force on the vendor a contract to sell at another price is a totally different thing. The question of salaries stands in this wise. Burland's salary as manager was fixed in the year 1879 at $5000 per annum. This was increased from time to time to $12,000. It was not disputed that he is entitled to draw a salary of that amount, and both courts have so held. But in addition to this fixed salary he has since 1888 drawn a further sum of large amount to which he claims to be entitled under the terms of a resolution of the board of directors of 24 April 1888. The Chief Justice held that the title to this increment as well as to the fixed salary was a question of internal management, and dismissed this part of the respondents' claim. The Court of Appeal thought that the question turned on the true construction of the resolution referred to, and, holding that Burland was not entitled to the increment under the terms of the resolution, ordered him to repay the amount thereof drawn by him since the date of the resolution. The amount which he is directed to repay on this account is $ 53,000 or thereabouts. Their Lordships agree with the Court of Appeal that Burland's right to retain this sum depends on the construction of the resolution, and it was so put by his counsel, Mr. Blake. The resolution is in the following terms: "The manager read letters from Mr. Goodeve and Mr. Ross with reference to their salaries and removal to Ottawa, and, having made explanation of the difficulties arising out of necessity for removal to Ottawa, it was resolved that the manager be requested to make the best arrangement he can with reference to the assistance given the employees, and that an increase of salary be given the staff equal to 5 per cent on the capital stock held by each of them to meet all difficulties incurred owing to such removal." The first observation which arises on this resolution is that prima facie the amount of stock held by the members of the "staff" bears no relation to the value of their services. But it was not contended that the resolution was *ultra vires,* and Mr. Blake was perhaps right in saying that it must be looked at in the concrete, and that the directors who passed it probably knew the holdings of the members of the "staff" and how it would work. But what is the effect and construction of the resolution? Who are the "employees"? Who are the "staff"? Are they the same or a different

set of people? And is the manager a member of the "staff" within the meaning of the resolution? This question is one of considerable difficulty. Some, but having regard to Burland's position in the company, not much weight is to be given to the company having acted on his construction for ten years or more. On the whole their Lordships are not prepared to differ from the Court of Appeal on this point. In the circumstances, they think that Burland cannot have been intended to be included in the "staff". At best the resolution is ambiguous, and, considering Burland's position, it is not unfair to invoke against him the rule of construction *contra proferentem.* He was the leading man in these transactions, and it rested on him to make it clear that a resolution under which he claims a much larger benefit than anybody else should carry that meaning on the face of it. The same question arises with regard to the appellant J. H. Burland, though in his case the sum in question is not so large. The last-named appellant was, at the date of the resolution, secretary of the company, and there does not seem to be any valid reason why he should not be included in the "staff". There is, however, a further point with regard to J. H. Burland. It appears that he ceased to hold the office of secretary in 1895, when he was appointed vice-president, but, in the resolution appointing him to the latter office, there is no mention of salary. Therefore, say the respondents, he is not entitled as vice-president to any salary or to the increment under the resolution of 24 April 1888. There is evidence that there was a change in the distribution of offices in 1895, and that J. H. Burland continued to do the same class of work as he had done as secretary, that office having been united with that of treasurer. He was allowed by the directors to continue to draw his former salary without any observation until the commencement of the present action, and their Lordships think that the inference may fairly be drawn from all the circumstances of the case that he was intended to retain his salary, although, there was a shifting of the offices. The disposal of the costs of the action involves some complication and difficulty of adjustment. By the decree of the Chief Justice, the defendants were ordered to pay to the plaintiffs their costs of the action. This decree, however, was superseded by the order of the Court of Appeal. The defendants have now succeeded on all questions relating to the accumulated fund and as to the sale of the lithographic plant. On the other hand, they have failed as to Burland's salary, and succeeded as to J.H. Burland's salary. It would be almost impossible to do justice by a strict apportionment of the costs of the action up to trial, and to endeavour to do so would lead to certain inconvenience and consequent expense in taxation. On the consideration of all the circumstances, their Lordships think that justice will be met by (1) discharging all orders as to costs made in the courts below; (2) directing the plaintiffs to pay to the defendants two-thirds of their costs of the action up to and including the trial; (3) directing the defendants to pay to the plaintiffs two-thirds of the costs of the plaintiffs' appeal to the Court of Appeal, which rightly succeeded as to Burland, but ought to have failed as to J. H. Burland, and the plaintiffs to pay to the defendants two-thirds of the costs of the defendants' appeal to the Court of Appeal, which ought to have succeeded except as to the directions for Burland accounting.

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Regal (Hastings),Ltd. v. *Gulliver*

(1942) 1 All ER 378 : (1967) 2 A.C. 134 (H.L.)

The appellants, Regal (Hastings) Ltd. ("Regal") were plaintiffs in the action and the respondents Charles Gulliver, Arthur Frank Bibby, David Edward Griffiths, Henry Charles Bassett, Harry Bentley and Peter Garton were the defendants.

The action was brought by Regal against the first five respondents who were former directors of Regal, to recover from them sums of money amounting to £7,018 8s. 4d., being profits made by them upon the acquisition and sale by them of shares in a subsidiary company formed by Regal and known as Hastings Amalgamated Cinemas Ltd. The action was brought against the respondent Garton, who was Regal's former solicitor, to recover a sum of £1,402 1s. 8d. and also a sum of £233 15s. in respect of a solicitor's bill of costs, the former sum being profit made by him in a similar dealing in the said shares and the latter sum being a sum paid to him by Regal in respect of work purported to have been done on their behalf. There were alternative claims for damages and misfeasance and for negligence.

The action was based upon the allegation that the directors and the solicitor had used their position as such to acquire the shares in Amalgamated for themselves with a view to enabling them at once to sell them at a very substantial profit, that they had obtained that profit by using their offices as directors and solicitor and were therefore accountable for it to Regal, and also that in so acting they had placed themselves in a position in which their private interests were likely to be in conflict with their duty to Regal.

VISCOUNT SANKEY - The appellants were the plaintiffs in the action and are referred to as Regal; the respondents were the defendants. The action was brought by Regal against the first five respondents, who were former directors of Regal, to recover from them sums of money amounting to £7,010 8s. 4d., being profits made by them upon the acquisition and sale by them of shares in the subsidiary company formed by Regal and known as Hastings Amalgamated Cinemas Ltd. This company is referred to as Amalgamated. The action was brought against the defendant, Garton, who was Regal's former solicitor, to recover the sum of £1,402 1s. 8d., being profits made by him in similar dealing in the said shares. There were alternative claims for damages and misfeasance and for negligence. The action was based on the allegation that the directors and the solicitor had used their position as such to acquire the shares in Amalgamated for themselves, with a view to enabling them at once to sell them at a very substantial profit, that they had obtained that profit by using their offices as directors and solicitor and were, therefore, accountable for it to Regal, and also that in so acting they had placed themselves in a position in which their private interests were likely to be in conflict with their duty to Regal. The facts were of a complicated and unusual character. I have had the advantage of reading and I agree with the statement as to them prepared by me noble and learned friend, Lord Russell to Killowen. It will be sufficient for my purpose to set them out very briefly.

In the summer of 1935 the directors of Regal, with a view to the future development or sale of their company, were anxious to extend the sphere of its operations by the acquisition of other cinemas. In Hastings and St. Leonards there were two small ones called the Elite and

the De Luxe. Negotiations began both for their acquisition or control by lease or otherwise and for the disposal of Regal itself. Part of the machinery for the purpose was the creation by Regal of a subsidiary company, the Amalgamated. It was registered on September 26, 1935, with a capital of £5,000 in £1 shares. The directors were the same as those of Regal with the addition of Garton. It was thought that only £2,000 of the capital was to be issued and that it would be subscribed by Regal, who would control it. Then difficulties began with the Elite and the De Luxe as to a lease, amongst others whether the directors of Amalgamated would guarantee the rent. The directors were not willing to do so. At last all difficulties were surmounted at a crucial meeting of October 2, 1935. It was a peculiar meeting. The directors both of Regal and Amalgamated were summoned to attend at the same place and at the same time. They did so, but, although separate minutes were subsequently attributed to each company, it is not easy to say from the evidence at any particular moment for which company a particular director was appearing. It was resolved that Regal should apply for 2,000 shares in Amalgamated. It was agreed that £2,000 was the total sum which Regal could find. The value of the leases of the two cinemas was taken at £15,000. The draft lease was approved. Each of the Regal directors, except Gulliver, the chairman, agreed to apply for 500 shares, Gulliver saying he would find people to take up 500. The Regal directors requested Garton to take up 500. I will deal later with particular evidence applying to Gulliver and Garton, who delivered separate defences. Thus, the capital of Amalgamated was fully subscribed, Regal taking 2,000 shares, the five respondents taking 500 shares each, and the persons found by Gulliver the remaining 500. The shares were duly paid for and allotted. In the final transaction shortly afterwards these shares were sold at substantial profit, and it is this profit which Regal asks to recover in this action.

The directors gave evidence and were severely cross-examined as to their good faith. The trial judge said:

> "All this subsequent history does not help me to decide whether the action of the directors of the plaintiff company and their solicitor on October 2 was bonafide in the interests of the company and not malafide and in breach of their duty to the company…I must take it that, in the realisation of those facts, it means that I cannot accept what has to be established by the plaintiff, and that is that the defendants here acted in ill faith…Finally, I have to remind myself, were it necessary, that the burden of proof, as in a criminal case, is the plaintiffs', who must establish the fraud they allege. On the whole, I do not think the plaintiff company succeeds in doing that and, therefore, there must be judgment for the defendants."

This latter statement was criticised in the Court of Appeal by Du Parcq L.J., who said:

> "To anyone who has read the pleadings, but not followed the course of the trial, that would seem a remarkable statement, because it is common ground that there is no allegation of fraud in the pleadings whatever…but the course which the case has taken makes the learned judge's statement quite apprehensible, because it does appear to have been put before him as, in the main at any rate, a case of fraud. It must be taken, therefore, that the respondents acted bonafide and without fraud."

In the Court of Appeal, Lord Greene M.R. said:

> "If the directors in coming to the conclusion that they could not put up more than £2,000 of the company's money had been acting in bad faith, and if that restriction of the company's investment had been done for the dishonest purpose of securing for themselves profit which not only could but which ought to have been procured for their company, I apprehend that not only could they not hold that profit for themselves if the contemplated transaction had been carried out, but they could not have held that profit for themselves even if that transaction was abandoned and another profitable transaction was carried through in which they did in fact realise a profit through the shares…but once they have admittedly bonafide come to the decision to which they came in this case, it seems to me that their obligation to refrain from acquiring these shares came to an end. In fact, looking at it as a matter of business, if that was the conclusion they came to, a conclusion which, in my judgment, was amply justified by the evidence from a business point of view, then there was only one way left of raising the money, and that was putting it up themselves…That being so, the only way in which these directors could secure that benefit for the company was by putting up the money themselves. Once that decision is held to be a bonafide one and fraud drops out of the case, it seems to me there is only one conclusion, namely, that the appeal must be dismissed with costs."

It seems therefore that the absence of fraud was the reason of the decision. In the result, the Court of Appeal dismissed the appeal and from their decision the present appeal is brought.

The appellants say they are entitled to succeed: (i) because the respondents secured for themselves the profits upon the acquisition and sale of the shares in Amalgamated by using the knowledge acquired as directors and solicitors respectively of Regal and by using their said respective positions and without the knowledge or consent of Regal; (ii) because the doctrine laid down with regard to trustees is equally applicable to directors and solicitors. Although both in the court of first instance and the Court of Appeal the question of fraud was the prominent feature, the appellants' counsel in this House at once stated that it was no part of his case and quite irrelevant to his arguments. His contention was that the respondents were in a fiduciary capacity in relation to the appellants and, as such, accountable in the circumstances for the profit which they made on the sale of the shares.

As to the duties and liabilities of those occupying such a fiduciary position, a number of cases were cited to us which were not brought to the attention of the trial judge. In my view, the respondents were in a fiduciary position and their liability to account does not depend upon proof of malafides. The general rule of equity is that no one who has duties of a fiduciary nature to perform is allowed to enter into engagements in which he has or can have a personal interest conflicting with the interests of those whom he is bound to protect. If he holds any property so acquired as trustee, he is bound to account for it to his cestui que trust. The earlier cases are concerned with trusts of specific property: ***Keech* v. *Sandford*** [(1726), Sel. Cas. Ch. 61], *per* Lord King L.C. The rule, however, applies to agents, as, for example, solicitors and directors, when acting in a fiduciary capacity.

It is not, however, necessary to discuss all the cases cited, because the respondents admitted the generality of the rule as contended for by the appellants, but were concerned

rather to confess and avoid it. Their contention was that, in this case, upon a true perspective of the facts, they were under no equity to account for the profits which they made. I will defeat first with the respondents, other that Gulliver and Garton. We were referred to ***Imperial Hydropathic Hotel Co. Blackpool* v. *Hampson,*** [(1882) 23 ChD 1, 12] where Bowen L.J., drew attention to the difference between directors and trustees, but the case is not an authority for contending that a director cannot come within the general rule. No doubt there may be exceptions to the general rule, as, for example, where a purchase is entered into after the trustee has divested himself of his trust sufficiently long before the purchase to avoid the possibility of his making use of special information acquired by him as trustee (see the remarks of Lord Eldon in ***Ex parte James,***[(1803), 8 Ves. 337, 352] or where he purchases with full knowledge and consent of his cestui que trust. ***Imperial Hydropathic Hotel Co., Blackpool* v. *Hampson,*** [23 ChD 1] makes no exception to the general rule that a solicitor or director, if acting in a fiduciary capacity, is liable to account for the profits made by him from knowledge acquired when so acting.

It was then argued that it would have been a breach of trust for the respondents, as directors of Regal, to have invested more than £ 2,000 of Regal's money in Amalgamated, and that the transaction would never have been carried through if they had not themselves put up the other £3,000. Be it so, but it is impossible to maintain that, because it would have been a breach of trust to advance more than £ 2,000 from Regal and that the only way to finance the matter was for the directors to advance the balance themselves, a situation for which brought the respondents outside the general rule and permitted them to retain the profits which accrued to them from the action they took. At all material times they were directors and in a fiduciary position, and they used and acted upon their exclusive knowledge acquired as such directors. They framed resolutions by which they made a profit for themselves. They sought no authority from the company, to do so, and, by reason of their position and actions, they made large profits for which, in my view, they are liable to account to the company.

I now pass to the cases of Gulliver and Garton. Their liability depends upon a careful examination of the evidence. Gulliver's case is that he did not take any shares and did not make any profit by selling them. His evidence, which is substantiated by the documents, is as follows. At the board meeting of October 2 he was not anxious as put any money of his own into Amalgamated. He thought he could find subscribers for £ 500 but was not anxious to do so. He did, however, find subscribers - £ 200 by South Down Land Company, £100 by a Miss Geering and £ 200 by Seguliva A.G., a Swiss company. The purchase price was paid by these three, either by cheque or in account, and the shares were duly allotted to them. The shares were held by them on their own account. When the shares were sold, the moneys went to them, and no part of the moneys went into Gulliver's pocket or into his account. In these circumstances, and bearing in mind that Gulliver's evidence was accepted, it is clear that he made no profits for which he is liable to account. The case made against him rightly fails, and the appeal against the decision in his favour should be dismissed.

Garton's case is that in taking the shares he acted with the knowledge and consent of Regal, and that consequently he comes within the exception to the general rule as to the liability of the person acting in a fiduciary position to account for profits. At the meeting of October 2, Gulliver, the chairman of Regal, and his co-directors were present. He was asked

in cross-examination about what happened as to the purchase of the shares by the directors. The question was:

> "Did you say to Mr. Garton, 'Well, Garton, you have been connected with Bentley's for a long time, will you not put up £ 500?' "

His answer was:

> "I think I can put it higher. I invited Mr. Garton to put the £500 and to make up the £ 3,000."

This was confirmed by Garton in examination in chief. In these circumstances, and bearing in mind that this evidence was accepted, it is clear that he took the share with the full knowledge and consent of Regal and that he is not liable to account for profits made on their sale. The appeal against the decision in his favour should be dismissed.

The appeal against the decision in favour of the respondents other than Gulliver and Garton should be allowed, and I agree with the order to be proposed by my noble and learned friend Lord Russell of Killowen as to amounts and costs. The appeal against the decision in favour of Gulliver and Garton should be dismissed with costs.

LORD RUSSELL OF KILLOWEN – My Lords, the very special facts which have led up to this litigation require to be stated in some detail, in order to make plain the point which arises for decision on this appeal.

The appellant is a limited company called Regal (Hastings), Ltd., and may conveniently be referred to as Regal. Regal was incorporated in the year 1933 with an authorised capital of £2,000 divided into 17,500 preference shares of £1 each and 50,000 ordinary shares of one shilling each. Its issued capital consisted of 8,950 preference shares and 50,000 ordinary shares. It owned, and managed very successfully, a freehold cinema theatre at Hastings called the Regal. In July, 1935, its board of directors consisted of one Walter Bentley and the respondents Gulliver, Bobby, Griffiths and Bassett. Its shareholders were twenty in number. The respondent Garton acted as its solicitor.

In or about that month, the board of Regal formed a scheme for acquiring a lease of two other cinemas (viz., the Elite at Hastings, and the Cinema de Luxe at St. Leonards), which were owned and managed by a company called Elite Picture Theatres (Hastings & Bristol), Ltd. The scheme was to be carried out by obtaining the grant of a lease to a subsidiary limited company, which was to be formed by Regal, with a capital of 5,000 £1 shares, of which Regal was to subscribe for 2,000 in cash, the remainder being allotted to Regal or its nominees as fully paid for services rendered. The whole beneficial interest in the lease would, if this scheme were carried out, enure solely to the benefit of Regal and its shareholders, through the shareholding of Regal in the subsidiary company. The respondent Garton, on the instructions of Regal, negotiated for the acquisition of the lease, with the result that an offer to take a lease for 35 or 42 years at a rent of £4,600 for the first year, rising in the second and third years up to £ 5,000 in the fourth and subsequent years, was accepted on behalf of the owners on August 21, 1935, subject to mutual approval of the form of the lease. Subsequently, the owners of the two cinemas required the rent under the proposed lease to be guaranteed.

On September 11, 1935, Walter Bentley died; and on September 18, 1935, his son, the respondent Bentley, who was one of his executors, was appointed as director of Regal. It should now be stated that, the concurrently with the negotiations for the acquisition of a lease of the two cinemas, Regal was contemplating a sale of its own cinema, together with the leasehold interest in the two cinemas which it was proposing to acquire. On September 18, 1935, at a board meeting of Regal, the respondent Garton was instructed that the directors were prepared to give a joint guarantee of the rent of the two cinemas, until the subscribed capital of the proposed subsidiary company amounted to £ 5,000. He was further instructed to deal with all offers received for the purchase of Regal's own assets. On September 26, 1935, the proposed subsidiary company was registered under the name Hastings Amalgamated Cinemas, Ltd., which may, for brevity, be referred to as Amalgamated. Its directors were the five directors of Regal, and in addition the respondent Garton.

Harry Bentley, who had been appointed a director of Regal only on September 18, at the end of the board meeting of that date, inquired from Garton the position as regards the new company, Amalgamated. In reply, he received a letter dated September 26, 1935, in which the position, as at that date, is set out by Garton. After stating that the capital of Amalgamated is £ 5,000, of which £ 2,000 is being subscribed by Regal, "which sum will form virtually the whole of the present paid up capital" of Amalgamated, and that the rent is to be guaranteed by the directors so long as the issued capital of Amalgamated is under £5,000, he concludes as follows:

> "Inasmuch, as it is the intention of all the parties that the Regal (Hastings), Ltd. will not only control the Hastings (Amalgamated) Cinemas, Ltd., but will continue to hold virtually the whole of the capital, the position of a shareholder of Regal (Hastings), Ltd., is merely that he has the advantage of a possible asset of the two new cinemas on sale by the Regal (Hastings) Ltd., of its undertaking, so that the price realised to the shareholders of the Regal (Hastings) Ltd., will be the amount that he would normally have received for his interest in such company, plus his proportion of the sale price of such two new cinemas."

On October 2, 1935, an offer was received from would-be purchasers offering a net sum of £ 92,500 for the Regal cinema and the lease of the two cinemas. Of this sum £ 77,500 was allotted as the price of Regal's cinema, and £ 15,000 as the price of the two leasehold cinemas. The splitting of the price seems to have been done by the purchasers at the request of the respondent Garton; but it must be assumed in favour of the Regal directors that they were satisfied that £ 77,500 was not too low a price to be paid for their company's cinema, with the result that £ 15,000 cannot be taken to have been in excess of the value of the lease which Amalgamated was about to acquire. On the afternoon of October 2, the six respondents met at 62, Shaftesbury Avenue, London, the registered office of Regal. Various matters were mentioned and discussed between them, and they came to certain decisions. Subsequently, minutes were prepared which record the different matters as having been transacted at two separate and distinct board meetings, viz., a meeting of the board of Regal, and a meeting of the board of Amalgamated. The respondent Gulliver stated in his evidence that two separate meetings, were held, that of the Amalgamated board being held and concluded before that of the Regal board was begun. On the other hand, the respondent Bentley says:

"It was more or less held in one lump, because we were talking about selling the three properties."

The respondent, Garton, states that, after it was decided that Regal could only afford to put up £ 2,000 in Amalgamated, which was purely a matter for the consideration of the Regal board, the next matter discussed was one which fig*ur*es in the minutes of the Amalgamated board meeting. Moreover, both meetings are recorded in the minutes as having been held at 3 p.m.

Whatever may be the truth as to this, the matters discussed and decided included the following: (i) Regal was to apply for 2,000 share in Amalgamated; (ii) the offer of £ 77,500 for the Regal cinema and £ 15,000 for the two leasehold cinemas was accepted; (iii) the solicitor reporting that completion of the lease was expected to take place on October 7, it was resolved that the seal of Amalgamated be affixed to the engrossment when available; and (iv) the respondent, Gulliver, having objected to guaranteeing the rent, it was resolved:

"…that the directors be invited to subscribe for 500 shares each and that such shares be allotted accordingly."

On October 7, 1935, a lease of the two cinemas was executed in favour of Amalgamated, for the term of 35 years from September 29, 1935, in accordance with the agreement previously come to. The shares of Amalgamated were all issued, and were allotted as follows: 2,000 to Regal, 500 to each of the respondents, Bobby, Griffiths, Bassett, Bentley and Garton and (by the direction of the respondent, Gulliver) 200 to a Swiss Company called Seguliva A.G., 200 to a company called South Downs Land Co. Ltd., and 100 to a Miss Geering.

In fact, the proposed sale and purchase of the Regal cinema and the two leasehold cinemas fell through. Another proposition, however, took its place, viz., a proposal for the purchase from the individual shareholders of their shares in Regal and Amalgamated. This proposal came to maturity by agreements dated October 24, 1935, as a result of which the 3,000 shares in Amalgamated held otherwise than by Regal were sold for a sum of £3 16s. 1d. per share, or in other words at a profit of £ 2 16s. 1d. per share over the issue price of par.

As a sequel to the sale of the shares in Regal, that company came under the management of a new board of directors, who caused to be issued the writ which initiated the present litigation. By this action Regal seek to recover from its five former directors and its former solicitor a sum of £ 8,142,10s. either as damages or as money had and received to the plaintiffs' use. The action was tried by Wrottesley J., who entered judgment for all the defendants with costs. An appeal by the plaintiffs to the Court of Appeal was dismissed with costs.

My Lords, those are the relevant facts which have led up to the debate in your Lordships' House, and I now proceed to consider whether the appellants are entitled to succeed against any and which of the respondents. The case has, I think, been complicated and obscured by the presentation of it before the trial judge. If a case of wilful misconduct or fraud on the part of the respondents had been made out, liability to make good to Regal any damage which it had thereby, suffered could, no doubt, have been established; and efforts were apparently made at the trial, by cross-examination and otherwise to found such a case. It is, however, due to the respondents to make it clear at the outset that this attempt failed. The case was not

so presented to us here. We have to consider the question of the respondents' liability on the footing that, in taking up these shares in Amalgamated, they acted with bonafides, intending to act in the interest of Regal.

Nevertheless, they may be liable to account for the profits which they have made, if, while standing in a fiduciary relationship to Regal, they have by reason and in course of that fiduciary relationship made a profit. This aspect of the case was undoubtedly raised before the trial judge, but, in so far as he deals with it in his judgment, he deals with it on a wrong basis. Having stated at the outset quite truly that what he calls "this stroke of fortune" only came the way of the respondents because they were the directors and solicitor of the Regal, he continues thus:

> "But in order to succeed the plaintiff company must show that the defendants both ought to have caused and could have caused the plaintiff company to subscribe for these shares, and that the neglect to do so caused a loss to the plaintiff company. Short of this, if the plaintiffs can establish that, though no loss was made by the company, yet a profit was corruptly made by the directors and the solicitor, then the company can claim to have that profit handed over to the company, framing the action in such a case for money had and received by the defendants for the plaintiffs' use."

Other passages in his judgment indicate that, in addition to this "corrupt" action by the directors, or, perhaps, alternatively, the plaintiffs, in order to succeed must prove that the defendants acted mala fide, and not bona fide in the interests of the company, or that there was a plot or arrangement between them to divert from the company to themselves a valuable investment. However relevant such considerations may be in regard to a claim for damages resulting from misconduct, they are irrelevant to a claim against a person occupying a fiduciary relationship towards the plaintiff for an account of the profits made by that person by reason and in course of that relationship.

In the Court of Appeal, upon this claim to profits, the view was taken that in order to succeed the plaintiff had to establish that there was a duty on the Regal directors to obtain the shares for Regal. Two extracts from the judgment of Lord Greene M.R., show this. After mentioning the claim for damages, he says:

> "The case is put on an alternative ground. It is said that, in the circumstances of the case, the directors must be taken to have been acting in the matter of their office when they took those shares; and that accordingly they are accountable for the profits which they have made…There is one matter which is common to both these claims which, unless it is established, appears to me to be fatal. It must be shown that in the circumstances of the case it was the duty of the directors to obtain these shares for their company."

Later in his judgment he uses this language:

> "But it is said that the profit realised by the directors on the sale of the shares must be accounted for by them. That proposition involves that on October 2, when it was decided to acquire these shares, and at the moment when they were acquired by the

directors, the directors were taking to themselves something which properly belong to their company."

Other portions of the judgment appear to indicate that upon this claim to profits, it is a good defence to show bona fides or absence of fraud on the part of the directors in the action which they took, or that their action was beneficial to the company, and the judgment ends thus:

"That being so, the only way in which these directors could secure that benefit for their company was by putting up the money themselves. Once that decision is held to be a bona fide one, and fraud drops out of the case, it seems to me that there is only one conclusion, namely, that the appeal must be dismissed with costs."

My Lords, with all respect I think there is a misapprehension here. The rule of equity which insists on those, who by use of a fiduciary position make a profit, being liable to account for that profit, in no way depends on fraud, or absence of bona fides; or upon such questions or considerations as whether the profit would or should otherwise have gone to the plaintiff, or whether the profiteer was under a duty to obtain the source of the profit for the plaintiff, or whether he took a risk or acted as he did for the benefit of the plaintiff, or whether he took a risk or acted as he did for the benefit of the plaintiff, or whether the plaintiff has in fact been damaged or benefited by his action. The liability arises from the mere fact of a profit having, in the stated circumstances, been made. The profiteer, however honest and well-intentioned, cannot escape the risk of being called upon to account.

The leading case of ***Keech* v. *Sandford*** [Sel. Cas. Ch. 61] is an illustration of the strictness of this rule of equity in this regard, and of how far the rule is independent of these outside consideration. A lease of the profits of a market had been devised to a trustee for the benefit of an infant. A renewal on behalf of the infant was refused. It was absolutely unobtainable. The trustee, finding that it was impossible to get a renewal for the benefit of the infant, took a lease for his own benefit. Though his duty to obtain it for the infant was incapable of performance, nevertheless he was ordered to assign the lease to the infant upon the bare ground that, if a trustee on the refusal to renew might have a lease for himself, few renewals would be made for the benefit of cestuis que trust. Lord King L.C. said:

"This may seem hard, that the trustee is the only person of all mankind who might not have the lease: but it is very proper that the rule should be strictly pursued, and not in the least relaxed…"

One other case in equity may be referred to in this contention, viz., ***Ex parte James,*** [8 Ves. 337], decided by Lord Eldon L.C. That was a case of a purchase of a bankrupt's estate by the solicitor to the commission, and Lord Eldon L.C., refers to the doctrine thus:

"This doctrine as to purchases by trustees, assignees, and persons having a confidential character, stands much more upon general principles than upon the circumstances of any individual case. It rests upon this: that the purchase is not permitted in any case however honest the circumstances; the general interests of justice requiring it to be destroyed in every instance; as no court is equal to the examination and ascertainment of the truth in much the greater number of cases."

Let me now consider whether the essential matters, which the plaintiff must prove, have been established in the present case. As to the profit being in fact made there can be no doubt. The shares were acquired at part and were sold three weeks later at a profit of £ 2 16s. 1d. per share. Did such of the first five respondents as acquired these very profitable shares acquire them by reason and in course of their office of directors of Regal? In my opinion, when the facts are examined and appreciated, the answer can only be that they did. The actual allotment no doubt had to be made by themselves and Garton (or some of them) in their capacity as directors of Amalgamated; but this was merely an executive act, necessitated by the alteration of the scheme for the acquisition of the lease of the two cinemas for the sole benefit of Regal and its shareholders through Regal's shareholding in Amalgamated. That scheme could only be altered by or with the consent of the Regal board. Consider what in fact took place on October 2, 1935. The position immediately before that day is stated in Garton's letter of September 26, 1935. The directors were willing to guarantee the rent until the subscribed capital of Amalgamated reached £ 5,000. Regal was to control Amalgamated and own the whole of its share capital, with the consequence that the Regal shareholders would receive their proportion of the sale price of the two new cinemas. The respondents then meet on October 2, 1935. They have before them an offer to purchase the Regal cinema for £ 77,500, and the lease of the two cinemas for £ 15,000. The offer is accepted. The draft lease is approved and a resolution for its sealing is passed in anticipation of completion in five days. Some of those present, however, shy at giving guarantees, and accordingly the scheme is changed by the Regal directors in a vital respect. It is agreed that a guarantee shall be avoided by the six respondents bringing the subscribed capital up to £ 5,100. I will consider the evidence and the minute in a moment. The result of this change of scheme which only the Regal directors could bring about may not have been appreciated by them at the time; but its effect upon their company and its shareholders was striking. In the first place, Regal would no longer control Amalgamated, or own the whole of its share capital. The action of its directors had deprived it (acting through its shareholders in general meeting) of the power to acquire the shares. In the second place, the Regal shareholders would only receive a large reduced proportion of the sale price of the two cinemas. The Regal directors and Garton would receive the moneys of which the Regal shareholders were thus deprived. This vital alteration was brought about in the following circumstances–I refer to the evidence of the respondent Garton. He was asked what was suggested when the guarantees were refused, and this is his answer:

> "Mr. Gulliver said 'We must find it somehow. I am willing to find £500. Are you willing', turning to the other four directors of Regal, 'to do the same?' They expressed themselves as willing. He said, 'That makes £2,500', and he turned to me and said, 'Garton, you have been interested in Mr. Bentley's companies; will you come in to take £500?' I agreed to do so."

Although this matter is recorded in the Amalgamated minutes, this was in fact a decision come to by the directors of Regal, and the subsequent allotment by the directors of Amalgamated was a mere carrying into effect of this decision of the Regal board. The resolution recorded in the Amalgamated minute runs thus:

> "After discussion it was resolved that the directors be invited to subscribe for 500 shares each, and that such shares be allotted accordingly."

As I read that resolution, and my reading agrees with Garton's evidence, the invitation is to the directors of Regal, and is made for the purpose of effectuating the decision which the five directors of Regal had made, that each should take up 500 shares in the Amalgamated. The directors of Amalgamated were not conveying an "invitation" to themselves. That would be ridiculous. They were merely giving effect to the Regal directors' decision to provide £2,500 cash capital themselves, a decision which had been followed by a successful appeal by Gulliver to Garton to provide the balance.

My Lords, I have no hesitation in coming to the conclusion, upon the facts of this case, that these shares, when acquired by the directors, were acquired by reason, and only by reason of the fact that they were directors of Regal, and in the course of their execution of that office.

It now remains to consider whether in acting as directors of Regal they stood in a fiduciary relationship to that company. Directors of a limited company are the creatures of statute and occupy a position peculiar to themselves. In some respects they resemble trustees, in others they do not. In some respects they resemble agents, in others they do not. In some respects they resemble managing partners, in others they do not. In ***In re Forest of Dean Coal Mining Co***. [(1878) 10 Ch. D. 450] a director was held not liable for omitting to recover promotion money which had been improperly paid on the formation of the company. He knew of 'the improper payment, but he was not appointed a director until a later date. It was held that, although a trustee of settled property which included a debt would be liable for neglecting to sue for it, a director of a company was not a trustee of debts due to the company and was not liable. I cite two passages from the judgment of Sir George Jessel M.R.:

> "Directors have sometimes been called trustees, or commercial trustees, and sometimes they have been called managing partners, it does not matter what you call them so long as you understand what their true position is, which is that they are really commercial men managing a trading concern for the benefit of themselves and all other shareholders in it."

Later, after pointing out that traders have a discretion whether they shall sue for a debt, which discretion is not vested in trustees of a debt under a settlement, he said:

> "Again directors are called trustees. They are no doubt trustees of assets which have come to their hands, or which are under their control, but they are not trustees of a debt due to the company…A director is the managing partner of the concern and although a debt is due to the concern I do not think it right to call him a trustee of that debt which remains unpaid, though his liability in respect of it may in certain cases and in respects be analogous to the liability of a trustee."

The position of directors was considered by Kay J., in ***In re Faure Electric Accumulator Co.*** [(1888) 40 Ch. D. 141]. That was a case where directors had applied the company's money in payment of an improper commission, and a claim was made for the loss thereby occasioned to the company. In referring to the liability of directors, the judge pointed out that directors were not trustees in the sense of trustees of a settlement, that the nearest analogy to their position

would be that of a managing agent of a mercantile house with large powers, but that there was no analogy which was absolutely perfect and he added:

> "However, it is quite obvious that to apply to directors the strict rules of the Court of Chancery with respect to ordinary trustees might fetter their action to an extent which would be exceedingly disadvantageous to the companies they represeat."

In addition a passage from the judgment of Bowen L.J. in ***Imperial Hydropathic Hotel Co., Blackpool* v. *Hampson*** [23 Ch. D. 1, 12] may be usefully recalled. He said [(1874) 10 Ch. App. 96]:

> "I should wish…to begin by remarking this, that when persons who are directors of a company are from time to time spoken of by judges as agents, trustees, or managing partners of the company, it is essential to recollect that such expressions are not used as exhaustive of the powers and responsibilities of those persons but only as indicating useful points of view from which they may for the moment and for the particular purpose be considered–points of view at which for the moment they seem to be either cutting the circle, or falling within the category of the suggested kind. It is not meant that they belong to the category, but that it is useful for the purpose of the moment to observe that they fall pro tanto within the principles which govern that particular class."

These three cases, however, were not concerned with the question of directors making a profit; but that the equitable principle in this regard applies to directors is beyond doubt. In ***Parker* v. *McKenna*** [(1874) 10 Ch. App. 96], a new issue of shares of a joint stock bank was offered to the existing shareholders at a premium. The directors arranged with one Stock to take, at a larger premium, the shares not taken up by the existing shareholders. Stock, being unable to fulfil his contract, requested the directors to relieve him of some. They did so, and made a profit. They were held accountable for the profit so made. Lord Cairns L.C. said:

> "The court will not enquire and is not in a position to ascertain, whether the bank has or has not lost by the acts of the directors. All the court has to do is to examine whether a profit has been made by an agent, without the knowledge of his principal, in the course and execution of his agency, and the court finds, in my opinion, that these agents in the course of their agency have made a profit, and for that profit they must, in my opinion, account to their principal."

In the same case James L.J. stated his view in the following terms:

> "…it appears to me very important that we should concur in laying down again and again the general principle that in this court no agent in the course of his agency, in the matter of his agency, can be allowed to make any profit without the knowledge of his principal; that the rule is an inflexible rule, and must be applied inexorably by this court, which is not entitled, in my judgment, to receive evidence, or suggestion, or argument, as to whether the principal did or did not suffer any injury in fact, by reason of the dealing of the agent; for the safety of mankind requires that no agent shall be able to put his principal to the danger of such an inquiry as that."

In ***Imperial Mercantile Credit Association (Liquidators)*** **v.** ***Coleman*** [(1873) L.R. 6 H.L. 189], one Coleman, a stockbroker and a director of a financial company, had contracted to place a large amount of railway debentures for a commission of 5 per cent. He proposed that his company should undertake to place them for a commission of 1½ per cent. The 5 per cent commission was in due course paid to the director.who paid over the 1 and a half percent to the company. He was held liable to account for the 3½ per cent, by Mallins V.C., [(1870) 6 Ch. App. 563] who said:

> "It is of the highest importance that it should be distinctly understood that it is the duty of directors of companies to use their best exertions for the benefit of those whose interests are committed to their charge, and that they are bound to disregard their own private interests whenever a regard to them conflicts with the proper discharge of such duty."

His decree was reversed by Lord Hatherley [(1871) 6 Ch. App. 558, 566 et. seq.] on the ground that the transaction was protected under the company's articles of association. Your Lordships' House, (L.R. 6 H.L. 189) however, thought that in the circumstances of the case the articles of association gave no protection, and restored the decree with unimportant variations. The liability was based on the view, which was not disputed by Lord Hatherley, that the director stood in a fiduciary relationship to the company. The relationship being established, he could not keep the profit which had been earned by the funds of the company being employed in taking up the debentures. The courts in Scotland have treated directors as standing in a fiduciary relationship towards their company and, applying the equitable principle, have made them accountable for profits accruing to them in the course and by reason of their directorships. It will be sufficient to refer to ***Huntington Copper Co.*** **v.** ***Henderson,*** [(1877) 4 R. 294, 308] in which the Lord President cites with approval the following passage from the judgment of the Lord Ordinary:

> "Whenever it can be shown that the trustee has so arranged matters as to obtain an advantage whether in money or money's worth to himself personally through the execution of his trust, he will not be permitted to retain, but he compelled to make it over to his constituent."

In the result, I am of opinion that the directors standing in a fiduciary relationship to Regal in regard to the exercise of their powers as directors, and having obtained these shares by reason and only by reason of the fact that they were directors of Regal and in the course of the execution of that office, are accountable for the profits which they have made out of them. The equitable rule laid down in ***Keech*** **v.** ***Sandford*** (Sel. Cas. Ch. 61) and ***Ex parte James*** (8 Ves. 337) and similar authorities applies to them in full force. It was contended that these cases were distinguishable by reason of the fact that it was impossible for Regal to get the shares owing to lack of funds, and that the directors in taking the shares were really acting as members of the public. I cannot accept this argument. It was impossible for the cestui que trust in ***Keech*** **v.** ***Sandford*** (Sel. Cas. Ch. 61) to obtain the lease, nevertheless the trustee was accountable. The suggestion that the directors were applying simply as members of the public is a travesty of the facts. They could, had they wished, have protected themselves by a resolution (either antecedent or subsequent) of the Regal shareholders in general meeting. In default of such approval, the liability to account must remain. The result is that, in my

opinion, each of the respondents Bobby, Griffiths, Bassett and Bentley is liable to account for the profit which he made on the sale of his 500 shares in Amalgamated.

The case of the respondent Gulliver, however, requires some further consideration, for he has raised a separate and distinct answer to the claim. He says: "I never promised to subscribe for shares in Amalgamated. I never did so subscribe. I only promised to find others who would be willing to subscribe. I only found others who did subscribe. The shares were theirs. They were never mine. They received the profit. I received none of it." If these are the true facts, his answer seems complete. The evidence in my opinion establishes his contention. Throughout his evidence Gulliver insisted that he only promised to find ££500, not to subscribe it himself. The £500 was paid by two cheques in favour of Amalgamated, one a cheque for £200 signed by Gulliver as director and on behalf of the Swiss company Seguliva, the other a cheque for £300 signed by Gulliver as managing director of South Downs Land Co., Ltd. They were enclosed in a letter of October 3, 1935, from Gulliver to Garton, in which Gulliver asks that the share certificates be issued as follows, 200 shares in the name of himself, Charles Gulliver, 200 shares in the name of South Downs Land Co., Ltd., and 100 shares in the name of Miss S. Geering. The money for Miss Geering's shares was apparently included in South Downs Land Co.'s cheque. The certificates were made out accordingly, the 200 shares in Gulliver's name being, he says, the shares subscribed for by the Swiss company.

When the sale and purchase of the Amalgamated shares was arranged, the agreement for the sale and purchase was signed on behalf of the vendor shareholders (other than the respondent Bentley) by Garton & Co., and in a letter of October 17, 1935, Gulliver sent to Garton (who held the three certificates) three transfers, viz. (1) a transfer of 200 shares executed by South Downs Land Co. Ltd. (2) a transfer of 200 shares executed by himself, and (3) a transfer of 100 shares executed by Miss Geering. When the purchase money was paid cheques were drawn as follows: a cheque for £360 in favour of Miss Geering, a cheque for £720 in favour of South Downs Land Co. Ltd., and a cheque for the same amount in favour of Gulliver. By letter of October 24, 1935, written by Gulliver to the National Provincial Bank, these cheques were paid into the respective accounts of Miss Geering, South Downs Land Co. Ltd., and Seguliva, A.G.

From the evidence of Gulliver it appeared that Miss Geering is a friend who from time to time makes investments on his advice; that the issued capital of South Downs and Co. Ltd., is £1,000 in £1 shares, held by some 11 or 12 shareholders, of whom Gulliver is one and holds 100 shares; and that in the Swiss company Gulliver holds 85 out of 500 shares.

It is of the first importance on this part of the case to bear in mind that these directors have been acquitted of all suggestion of mala fides in regard to the acquisition of these shares. They had no reason to believe that they could be called to account. Why then should Gulliver go to the elaborate pains of having the shares put into the names of South Downs Land Co. and Miss Geering, and of having the proceeds of sale paid into the respective accounts before mentioned, if the shares and proceeds really belonged to him? Ex hypothesi he had no reason for concealment; and no question was raised against the transaction until months after the proceeds of sale had been paid into the banking accounts of those whom Gulliver asserts to have been the owners of the shares. I can see no reason for doubting that the shares never belonged to Gulliver, and that he made no profit on the sale thereof.

Counsel for the appellant, however, contended that the trial judge had found as a fact that Gulliver was the owner of the shares; and he relied on certain scattered passages in the judgment, the strongest of which seems to me to be the one in which the judge said:

> "I may say this with regard to Mr. Gulliver, that i have not been misled in any way or led to decide in his favour by the fact that he handed over his shares to his nominees but rather the reverse."

I cannot regard that s a finding by the judge that the shares were subscribed for by Gulliver under aliases, and that the shares and the proceeds of sale in fact belonged to him. It is equally susceptible of the meaning that he allowed others to subscribe for the shares which he could have obtained for himself had he so wished. If it be claimed as a finding of fact in the former sense, all I can say is that there is no evidence which in my opinion would justify such a finding.

It was further argued that, even if the shares and the proceeds of sale did not belong to Gulliver, he is nevertheless liable to account to Regal for the profit made by the owners of the shares, and that upon the authority of ***Imperial Mercantile Credit Association (Liquidators)* v. *Coleman***, (L.R. 6 H.L. 189) to which I have already referred. One of the contentions put forward there by Coleman was that his transaction was a transaction for the benefit of a partnership in the profits of which he was only interested to the extent of a half, and that accordingly he could only be made accountable to that extent. That contention was disposed of by Lord Cairns in the following terms:

> "My Lords, I think there is no foundation for this argument. The profit on the transaction was obtained by Mr. Coleman, and, in the view that I take, was obtained by him as a director of the association. Whether he desired or whether he determined to reserve it all to himself or to share it with his firm appears to me to be perfectly immaterial. The source from which the profit is derived is Mr. Coleman. It is only through him that his firm can claim. He is liable for the whole of the profits which were obtained; and it is not the course for a Court of Equity to enter into the consideration of what afterwards would have become of those profits."

I am unable to see how this authority helps Regal if it be assumed that neither the shares nor the profit ever belonged to Gulliver.

It was further said that Gulliver must account for whatever profits he may have made indirectly through his shareholding in the two companies, and that an inquiry should be directed for this purpose. As to this, it is sufficient to say that there is no evidence upon which to ground such an inquiry. Indeed, the evidence so far as it goes, shows that neither company has distributed any part of the profit. Finally, it was said that Gulliver must account for the profit on the 200 shares as to which the certificate was in his name. If in fact the shares belonged beneficially to the Swiss company (and that is the assumption for this purpose), the proceeds of sale did not belong to Gulliver, and were rightly paid into the Swiss company's banking account. Gulliver accordingly made no profit for which he is accountable. As regards Gulliver, this appeal should, in my opinion, be dismissed.

There remains to consider the case of Garton. He stands on a different footing from the other respondents in that he was not a director of Regal. He was Regal's legal adviser; but, in

my opinion, he has a short but effective answer to the plaintiff's claim. He was requested by the Regal directors to apply for 500 shares. They arranged that they themselves should each be responsible for £500 of the Amalgamated capital, and they appealed, by their chairman, to Garton to subscribe the balance of £500 which was required to make up the £ 3,000. In law his action, which has resulted in a profit, was taken at the request of Regal, and I know of no principle or authority which would justify a decision that a solicitor must account for profit resulting from transaction which he has entered into on his own behalf, not merely with the consent, but at the request of his client.

My Lords, in my opinion the right way in which to deal with this appeal is (i) to dismiss the appeal as against the respondents Gulliver and Garton with costs, (ii) to allow it with costs as against the other four respondents, and (iii) to enter judgment as against each of these four respondents for a sum of £1,402 1s. 8d. with interest @ 4 per cent from October 25, 1935, as to £1,300 part thereof and from December 5, 1935, as to the balance. As regards the liability of these four respondents for costs, I have read the shorthand notes of the evidence at the trial, and it is clear to me that the costs were substantially increased by the suggestions of mala fides and fraud with which the cross-examination abounds, and from which they have been exonerated. In my opinion a proper order to make would be to order these four respondents to pay only three-quarters of the appellants' taxed costs of the action. The taxed costs of the appellants in the Court of Appeal and in this House they must pay in full.

One final observation I desire to make. In his judgment Lord Greene M.R., stated that a decision adverse to the directors in the present case involved the proposition that, if directors bona fide decide not to invest their company's funds in some proposed investment, a director who thereafter embarks his own money therein is accountable for any profits which he may derive therefrom. As to this, I can only say that to my mind the facts of this hypothetical case bear but little resemblance to the story with which we have had to deal.

LORD PORTER – My Lords, I have had an opportunity of reading the speech which has been delivered by my noble and learned friend. Lord Russell of Killowen, and had we not been differing from the view of the Court of Appeal I should not desire to add to what he has said. as we are reversing the judgment of both the court of first instance and the Court of Appeal I desire, out of respect for the opinions expressed in them, to state in the briefest possible compass the grounds for the view which I hold.

My Lords, I am conscious of certain possibilities which are involved in the conclusion which all your Lordships have reached. The action is brought by the Regal Company. Technically, of course, the fact that an unlooked for advantage may be gained by the shareholders of that company, is immaterial to the question at issue. The company and its shareholders are separate entities. One cannot help remembering, however, that in fact the shares have been purchased by a financial group who were willing to acquire those of the Regal and the Amalgamated at a certain price. As a result of your Lordships' decision that group will, I think, receive in one hand part of the sum which has been paid by the other. For the shares in Amalgamated they paid £ 3 16s. 1d. per share, yet part of that sum may be returned to the group, though not necessarily to the individual shareholders by reason of the enhancement in value of the shares in Regal – an enhancement brought about as a result of the

receipt by the company of the profit made by some of its former directors on the sale of Amalgamated shares. This, it seems, may be an unexpected windfall, but whether it be so or not, the principle that a person occupying a fiduciary relationship shall not make a profit by reason thereof is of such vital importance that the possible consequence in the present case is in fact as it is in law an immaterial consideration.

The plaintiff, the Regal Company, by its pleadings, claimed (i) damages for negligence, (ii) alternatively, the profit obtained on the sale of shares in Amalgamated as money had and received by the defendants to the plaintiffs' use, and (iii) in the further alternative damages for misfeasance. No claim for fraud was suggested, and the trial judge expressly exonerated the defendants from any liability for negligence or misfeasance. Before your Lordships' House the claim for money had and received was alone persisted in. The alternative claim for misfeasance, however, seems also to have been presented to the Court of Appeal, but to have been rejected by them, and in common with the rest of your Lordships I unreservedly accept the findings of both courts.

It remains, therefore, to consider the claim that (in the words of Lord Greene M.R.):

> "...in the circumstances of the case the directors must be taken to have been acting in the matter of their office when they took those shares and that, accordingly, they are accountable for the profits, which they have made."

That the shares were obtained by the defendants by reason of their position as directors of Regal is, I think, plain. The original proposition, when the formation of the subsidiary company was suggested, was that the whole of the shares should be issued to the Regal Company, partly for cash and partly for services rendered, and this proposition was discussed and accepted at board meetings of that company. It was only afterwards, when the necessity for finding £5,000 cash arose, that the issue to any one other than the company was considered, and then the directors turned to themselves. “There is no doubt it was only because they were directors and solicitor respectively of the plaintiff company that this stroke of fortune came their way”, says Wrottesley J., and I agree with his observation.

In these circumstances, it is to my mind immaterial that the directors saw no way of raising the money save from amongst themselves and from the solicitor to the company, or, indeed, that the money could in fact have been raised in no other way. The legal proposition may, I think be broadly stated by saying that one occupying a position of trust must not make a profit which he can acquire only by use of his fiduciary position, or, if he does, he must account for the profit so made. For this proposition the cases of ***Keetch* v. *Sandford*** [Sel. Cas. Ch. 61] and ***Ex parte James*** [8 Ves. 337] are sufficient authority. Wrottesley J. and the members of the Court of Appeal appear to have adopted a narrower outlook with which, with all respect, I find myself unable to agree. Wrottesley J. said:

> “In order to succeed the plaintiff company must show that the defendants both ought to have caused and could have caused the plaintiff company to subscribe for these shares and that the neglect to do so caused a loss to the plaintiff company.”

In the Court of Appeal, Lord Greene M.R. said:

"It must be shown that in the circumstances of the case it was the duty of the directors to obtain these shares for their company...The position of the Regal Company would have been very much strengthened by having all these shares in the two companies in the same hands with the possibility of the control. That being so, the only way in which these directors could secure that benefit for their company was by putting up the money themselves. Once that decision is held to be a bona fide one, and fraud drops out of the case, it seems to me there is only one conclusion, namely, that the appeal must be dismissed with costs."

To treat the problem in this way is, in my view, to look at it as involving a claim for negligence or misfeasance and to neglect the wider aspect. Directors, no doubt, are not trustees, but they occupy a fiduciary position towards the company whose board they form. Their liability in this respect does not depends upon breach of duty but upon the proposition that a director must not make a profit out of property acquired by reason of his relationship to the company of which he is director. It matters not that he could not have acquired the property for the company itself–the profit which he makes is the company's even though the property by means of which he made it was not and could not have been acquired on its behalf. Adopting the words of Lord Eldon L.C., in ***Ex parte James*** [8 Ves. 337, 345]:

"...the general interests of justice require it to be destroyed in every instance; as no court is equal to the examination and ascertainment of the truth in much the greater number of cases."

My Lords, these observations apply generally to the action, but the cases of Gulliver and Garton stand on a somewhat different footing. AS to them, there are additional and special considerations to be kept in mind. I need not set them out or refer to them further then by saying that I find myself in agreement with the reasoning and conclusion on my noble and learned friend, Lord Russell of Killowen, and would submit with him that the appeal should be allowed so far as concerns the defendants Bobby, Griffiths, Bassett and Bentley, and should be dismissed in the case of Gulliver and Garton. I also concur in the order as to costs which he suggests.

Appeal dismissed as against the respondents Gulliver & Garton.Appeal allowed as against the other respondents.

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Industrial Development Consultants Ltd. v. *Cooley*

(1972) 1 W.L.R. 443

The defendant, Neville Cooley, was former chief architect of the West Midlands Gas Board. In 1967 he met Mr. Howard Hicks, the chairman and managing director of a group of companies which included the plaintiff company, Industrial Development Consultants Ltd. The plaintiff company offered to large industrial enterprises, both in the public and private sectors, comprehensive construction services including those of architects, engineers and project managers. Mr. Hicks and the defendant came to an agreement that the defendant should be appointed managing director of the plaintiffs. Letters were exchanged between them mentioning a salary £6,000, various fringe benefits and a probationary period of six months to be followed by a contract for a period of five or seven years. In the event no written agreement was ever signed, but the defendant joined the plaintiffs as managing director with effect from February 1968. The idea behind his appointment was that in view of his past experience in the gas industry he would be able to help the plaintiffs to procure new business in the public sector, particularly in connection with the various gas boards.

In February 1968 the defendant entered into correspondence with the chairman of the Eastern Gas Board and their surveyor, a Mr. Lacey, exploring the possibility of the plaintiffs designing and constructing new depots for that board, but the defendant's proposition on behalf of the plaintiffs was rejected by the gas board.

In May 1969 a Mr. Smettom, the new deputy chairman of the Eastern Gas Board, made a tentative approach to the defendant in a private capacity about the proposed design and construction of new depots. They met on June 13, 1969, and although Mr. Smettom made no definite commitment, a depot at Letchworth was mentioned, and the defendant realised that if he could quickly get the necessary release from his obligations to the plaintiffs he stood a good chance of getting for his own benefit a very valuable contract from the gas board.

On June 16, 1969, the defendant went to Mr. Hicks and represented that his state of health was such that he could not carry on as managing director: believing the defendant to be seriously ill, Mr. Hicks released him as from August 1, 1969. It was found that the representation of ill health was untrue to the defendant's knowledge and thus dishonest and was a pretext in order to secure his quick release. The defendant proceeded to register on the Business Names Register 'Design Group for Industry' as a business of consultancy and multi-professional design project management, giving his private address and stating the date of starting business to be June 8, 1969. By a letter of June 17, the defendant informed Mr. Smettom, who had enquired about the defendant's involvement with the plaintiffs, that he had discussed the matter with Mr. Hicks who appreciated his (the defendant's) intentions.

After further correspondence with Mr. Smettom the defendant was on August 6 offered employment by the gas board for a large scheme which was found to be substantially the same business which the plaintiffs had been trying to get for themselves in 1968: four depots were to be constructed by the Eastern Gas Board at a capital cost then estimated at £1,700,000. The actual cost was likely to be considerably higher.

On December 2, 1969, the plaintiffs issued a writ against the defendant claiming a declaration that he was a trustee for them of all contracts with the board; an account of all fees

and remuneration received by and payable to him in respect of any such contracts; alternatively damages for breach of the defendant's duties as a director and managing director of the plaintiffs. By his defence the defendant denied that he was under a duty to the plaintiffs to disclose to them his conversations with the Eastern Gas Board, and he denied that the plaintiffs were entitled to the relief claimed.

ROSKILL J.-There can be no doubt that the defendant got this Eastern Gas Board contract for himself as a result of work which he did whilst still the plaintiffs' managing director. It is, of course, right to say that the contract for that work was not concluded until after he had left the plaintiffs. That work was work which the plaintiffs would very much have liked to have had and, indeed, was in substance the same work as they had unsuccessfully tried to get in 1968.

There are a number of other points with which it may be convenient to deal in rather summary form. It is only fair to the defendant to say that the negotiations for the Eastern Gas Board work were initiated in the first instance by Mr. Smettom and not by himself. At the time when Mr. Smettom first approached the defendant at the end of May 1969, Mr. Smettom knew that the plaintiffs had been interested in the previous proposals and had failed to get the work. He learned that the defendant was still with the plaintiffs as their managing director and was not then in private practice. It is important to realise that by the time the defendant and Mr. Smettom met on June 13 the defendant was desperately anxious to obtain this business for himself if he could succeed in doing so. He then learned, first, that the Eastern Gas Board were coming back, if I may use the phrase, into the market and were considering building these depots, secondly, that Mr. Smettom regarded the implementation of this project as urgent and thirdly, in round and general terms, the sort of capital sum which would be involved. All those matters vitally concerned the plaintiffs. At that time the defendant was still their managing director. He was still their managing director not only at the time when he met Mr. Smettom on June 13 but when he prepared those documents over the ensuing weekend, sending them off on June 17 so as to get this work for himself.

However, at the meeting of June 13, Mr. Smettom had made it absolutely plain to the defendant that no commitment was being made with the project, the time-table was likely to be urgent, it was necessary before there was any possibility of commitment being made for the defendant to satisfy Mr. Smettom that he (the defendant) was free of all obligations to the plaintiffs and it was up to the defendant to do whatever was necessary to obtain that freedom.

It is plain that at the meeting of June 13 the defendant became possessed of knowledge and information which was not possessed by his employers, the plaintiffs, knowledge which the plaintiffs would have wished to possess. When the defendant saw Mr. Hicks on June 16 he did so in order to obtain his freedom as quickly as possible. One might add, I hope not unfairly, that he was prepared to obtain his freedom by fair means or if necessary by foul. At that time the Letchworth part of the work was urgent because on the revised plan to which Mr. Smettom referred, the construction of Letchworth was going to cost the Eastern Gas Board of the order of a quarter of a million pounds. Unless the defendant could be free in time to enable him to meet Mr. Smettom's programme requirements, both for Letchworth and the rest, it seems plain Mr. Smettom would not in any event have given the defendant the job

ultimately given in the letter dated August 6. I might in this connection read the answer given by Mr. Smettom:

> "If I had known Mr. Cooley was under a contract to I.D.C. requiring six or 12 months' notice then unless I.D.C. had agreed to release him I would not have gone ahead."

When one looks at the letters of June 17 and the associated documents, there is disclosed the plainest conflict of interest between the defendant as potential architect or project manager of the Eastern Gas Board and as managing director of the plaintiffs. Finally I ought to say that I am sure Mr. Hicks would not have agreed to give the defendant the carteblanche release claimed by the defendant if he had known the full facts about the Eastern Gas Board project.

Mr. Davies, for the defendant, has forcefully described the cause of account for an account which is relied on in this case as misconceived. His admirable argument ran thus: true some directors are in a fiduciary relationship with their companies but when the defendant saw Mr. Smettom on June 13 Mr. Smettom made it plain that he was consulting the defendant not as managing director of Industrial Development Consultants Ltd. but in a private capacity. Therefore, what the defendant did on June 13 and thereafter was not done qua managing director of the plaintiffs. The information he received was not received qua managing director of the plaintiffs. On the contrary the information was given and received in a purely private capacity. There was thus no breach of any duty, even the barest contractual duty, in failing to pass that information on to the plaintiffs. Still less was there any breach of any fiduciary duty because, having regard to the fact that this information was received by the defendant in his private capacity, there could be no fiduciary obligation to pass on this information to Mr. Hicks or to his employers generally.

The argument continued that, that being the position, the defendant did not and could not have got this valuable Eastern Gas Board work by virtue of his position as managing director of the plaintiffs. Indeed, the converse of that was true because the defendant could never have got that work so long as he was their managing director. Therefore, none of the requirements indicated in some of the cases which have been referred to, notably ***Regal (Hastings) Ltd.*** **v.** ***Gulliver*** [(1967) 2 A.C. 134], have been satisfied.

Further, it was said that under no circumstances would the plaintiffs have ever got this work because of Mr. Smettom's and Mr. Lacey's objections in principle to the set-up, if I may use that phrase, not only of the plaintiffs but of the I.D.C. Group as a whole. Thus, the argument continued, there is no duty to account. The whole action is completely misconceived. If there be any claim here at all it must lie in damages but a claim for relief by way of an account cannot succeed.

Mr. Davies summarised his argument in this way: any duty which might otherwise have been owed to the plaintiffs by the defendant was eliminated by the nature of Mr. Smettom's approach which was from the outset a private approach. He pointed out that contracts in this connection fell into two different classes, first, contracts with a company in which the director is interested - in relation to those Mr. Davies said there was what he described as an inherent and inevitable conflict of interest and therefore there was duty to disclose and a consequential liability in the event of a failure to disclose - and, secondly, contracts with a third party with

which alone Mr. Davies submitted the court was concerned in this case. The relevant contract was not, as he put it, a contract with I.D.C. at all. It was a contract with a third party and being with a third party there was no inherent conflict between interest and duty unless it could be said that this contract was equally available to the plaintiffs as his employers. As it was a contract which was not available to the plaintiffs and with a third party there could be no duty to account.

Support for the principle upon which he relied is to be found in a number of text books such as **Lewin on *Trusts,*** 16th ed. (1964), and **Snell's *Principles of Equity,*** 26th ed. (1966). It is true that when one looks at the reported cases contracts made by a director with a company of which he is a director have usually been treated as falling into a distinct category. Mr. Davies relied in support of his argument upon the speech of Lord Blancsburgh in ***Bell* v. *Lever Brothers Ltd***. [(1932) A.C. 161, 167]. I shall not read all the passages from Lord Blanesburgh's speech which were read to me. I shall content myself in view of the hour with only reading a few passages which are immediately relevant. Lord Blanesburgh, after pointing out that the further direction of the judge might have sufficed had the fraud charged been found instead of negatived, said, at p. 193:

> "But that charge, like all the other charges of fraud, has disappeared, and the precise character in legal responsibility of the offending transactions stripped of fraud becomes of essential importance. And it was, I venture to think, quite misunderstood. The point here to be noted is that these transactions involved no contract or engagement in which, either for profit or loss, Niger was at all concerned. The contracts were all contracts by which the appellants alone were bound for their own benefit or burden to some outside party exclusive of Niger altogether. And this distinction is vital: because the liability of a director in respect of profits made by him from a contract in which his company also is concerned is one thing: his liability, if any there be, in respect of his profits from a contract in which the company has no interest at all is quite another. In the first case, unless by the company's regulations the director is permitted, subject to or without condition, to retain his profit, he must account for it to the company. In the second case, the company has no concern in his profit and cannot make him accountable for it unless it appears - this is the essential qualification – that in earning that profit he has made use either of the property of the company or of some confidential information which has come to him as a director of the company."

Pausing there for one moment, Mr. Davies argued that the defendant had made no use of the property of the plaintiffs nor of confidential information which had come to him as a director of the plaintiffs. But Mr. Davies agreed that the dichotomy was not complete and that there was a third class of case where a director might be called upon to account, namely, where he had misused his position as a director of a company.

What Lord Blanesburgh was dealing with was the application of well known and well established principles to the complicated facts of ***Bell* v. *Lever Brothers Ltd***. I think the right approach to the present case is first to consider the duty which a director (including a managing director) owes to the company of which he is a director. This has been the subject

of repeated statements in cases of the highest authority over the years. The law is summarised in **Buckley on *the Companies Acts,*** 13th ed. (1957), pp. 876-877:

> "Upon general rules of equity a person holding a fiduciary position as director cannot obtain for himself a benefit derived from the employment of the company's funds, unless the company knows and assents. No director can, in the absence of a stipulation to the contrary, partake in any benefit from a contract which requires the sanction of a board of which he is a member. He stands in a fiduciary position towards the company, and if he makes any profit when he is acting for the company, he must account to the company. It makes no difference that the profit is one which the company itself could not have obtained, the question being not whether the company could have acquired it, but whether the director acquired it while acting for the company, nor that the interest of the director is as a trustee for a third party. The reason for this is, that the company has a right to the service of its paid directors as an entire board; that it has a right to the advice of every director upon matters which are brought before the board for consideration; and that the general rule that no trustee can derive any benefit from dealing with the trust funds applies with still greater force to that state of things in which the interest of the trustee deprives the company of the benefit of his advice and assistance."

A more recent statement of the highest authority will be found in the speech of Lord Upjohn in ***Phipps* v. *Boardman*** [(1967) 2 A.C. 46, 123] onwards:

> "Rules of equity have to be applied to such a great diversity of circumstances that they can be stated only in the most general terms and applied with particular attention to the exact circumstances of each case. The relevant rule for the decision of this case is the fundamental rule of equity that a person in a fiduciary capacity must not make a profit out of his trust which is part of the wider rule that a trustee must not place himself in a position where his duty and his interest may conflict. I believe the rule is best stated in ***Bray* v. *Ford*** [(1896) A.C. 44, 51] by Lord Herschell, who plainly recognised its limitations: 'It is an inflexible rule of a court of equity that a person in a fiduciary position, such as the respondent's, is not, unless otherwise expressly provided, entitled to make a profit, he is not allowed to put himself in a position where his interest and duty conflict. It does not appear to me that this rule is, as has been said, founded upon principles of morality. I regard it rather as based on the consideration that, human nature being what it is, there is danger, in such circumstances, of the person holding a fiduciary position being swayed by interest rather than by duty, and thus prejudicing those whom he was bound to protect. It has, therefore, been deemed expedient to lay down this positive rule. But I am satisfied that it might be departed from in many cases, without any breach of morality, without any wrong being inflicted, and without any consciousness of wrong-doing. Indeed, it is obvious that it might sometimes be to the advantage of the beneficiaries that their trustee should act for them professionally rather than a stranger, even though the trustee were paid for his services.' It is perhaps stated most highly against trustees or directors in the celebrated speech of Lord Cranworth L.C. in ***Aberdeen Railway* v. *Blaikie*** [(1854) 1 Macq. 461, 471], where he said: 'And it is a rule of universal

application, that no one, having such duties to discharge, shall be allowed to enter into engagements in which he has, or can have, a personal interest conflicting, or which possibly may conflict, with the interest of those whom he is bound to protect.' The phrase 'possibly may conflict' requires consideration. In my view it means that the reasonable man looking at the relevant facts and circumstances of the particular case would think that there was a real sensible possibility of conflict; not that you could imagine some situation arising which might, in some conceivable possibility in events not contemplated as real sensible possibilities by any reasonable person, result in a conflict.

"Your Lordships were referred at length to the decision of this House in ***Regal (Hastings) Ltd.*** **v.** ***Gulliver***. That is a helpful case for its restatement of the well-known principles but the case itself bears no relation to the one before your Lordships. The facts were very different and I summarise them from the opinion of Lord Russell of Killowen at p. 140. The plaintiff company (Regal), the owner of a cinema, was contemplating the purchase of the leases of two other cinemas which were to be transferred to a subsidiary company formed by Regal called Amalgamated. Concurrently Regal was contemplating the sale of all three cinemas to a third party. The intention of the directors was that Regal should subscribe for shares in Amalgamated and then Regal would sell those shares to the third party. There was some trouble over providing a guarantee; the transaction was changed so that the directors of Regal subscribed for shares in Amalgamted instead of Regal itself and then those directors sold those shares to the third party, thereby making an immediate and handsome profit of £2 16s. 1d. per share. That was an obvious case where duty of the director and his interest conflicted. The scheme had been that Regal would make the profit, in fact its directors did. It was a clear case and does not really assist in the present case. It had long been settled in ***Keech*** **v.** ***Sandford*** [(1726) Sel. Cast. King (Macnaghten) 175] that the inability of beneficiary to obtain the renewal of a lease which was trust property and a renewal of which has always been considered to be trust property did not permit the purchase of that property by the trustee himself. That bears no relation to this case. This case, if I may emphasise it again, is one concerned not with trust property or with property which the persons to whom the fiduciary duty was owed were contemplating a purchase but in contrast to the facts in *Regal* with property which was not trust property nor property which was ever contemplated as the subject matter of a possible purchase by the trust.

There has been much discussion in the courts below and in this House upon the observations of their Lordships in the ***Regal*** case. But in my view, their Lordships were not attempting to lay down any new view on the law applicable and indeed could not do so for the law was already so well settled. The whole of the law is laid down in the fundamental principle exemplified in Lord Cranworth's statement I have already quoted. But it is applicable, like so many equitable principles which may affect a conscience, however innocent, to such a diversity of different cases that the observations of judges and even in your Lordships' House in cases where this great principle is being applied must be regarded as applicable only to the particular facts

of the particular case in question and not regarded as a new and slightly different formulation of the legal principle so well settled. Therefore, as the facts in *Regal* to which alone their Lordships' remarks were directed were so remote from the facts in this case I do not propose to examine the ***Regal*** case further."

I should have added that Lord Upjohn's speech was a dissenting speech. I do not, however, detect any difference in principle between the speeches of their Lordships but merely a difference in the application of the facts to principles which were not in dispute. Later Lord Upjohn stated four propositions as follows, at p. 127:

> '1. The facts and circumstances must be carefully examined to see whether in fact a purported agent and even a confidential agent is in a fiduciary relationship to his principal. It does not necessarily follow that he is in such a position. 2. Once it is established that there is such a relationship, that relationship must be examined to see what duties are thereby imposed upon the agent, what is the scope and ambit of the duties charged upon him. 3. Having defined the scope of those duties one must see whether he has committed some breach thereof and by placing himself within the scope and ambit of those duties in a position where his duty and interest may possibly conflict. It is only at this stage that any question of accountability arises. 4. Finally, having established accountability it only goes so far as to render the agent accountable for profits made within the scope and ambit of his duty."

I think Mr. Brown was right when he said in his reply that, that is the basic rule from which all else has been founded. Certainly Viscout Sankey in the ***Regal*** case, at p. 137, so stated it and Lord Cranworth's well known statement has been repeated in innumerable cases of the highest authority.

Therefore, the starting point for consideration of the present case is the application of the facts of this case to the propositions stated in ***Phipps* v. *Boardman*** [(1967) 2 A.C. 46, 127] by Lord Upjohn, bearing in mind, as Lord Upjohn said in the passage I have quoted, that the application of "this great principle" may be infinitely variable. It is the principle which is important and there is no limit, I venture to think, to the cases to which that principle can be applied, always provided that in applying it, the court does not go outside the well-established limits of the principle.

The first matter that has to be considered is whether or not the defendant was in a fiduciary relationship with his principals, the plaintiffs. Mr. Davies argued that he was not because he received this information which was communicated to him privately. With respect, I think that argument is wrong. The defendant had one capacity and one capacity only in which he was carrying on business at that time. That capacity was as managing director of the plaintiffs. Information which came to him while he was managing director and which was of concern to the plaintiffs and was relevant for the plaintiffs to know, was information which it was his duty to pass on to the plaintiffs because between himself and the plaintiffs a fiduciary relationship existed as defined in the passage I have quoted from **Buckley on the *Companies Act*** and, indeed, in the speech of Lord Cranworth L.C.

It seems to me plain that throughout the whole of May, June and July 1969 the defendant was in a fiduciary relationship with the plaintiffs. From the time he embarked upon his course

of dealing with the Eastern Gas Board, irrespective of anything which he did or he said to Mr. Hicks, he embarked upon a deliberate policy and course of conduct which put his personal interest as a potential contracting party with the Eastern Gas Board in direct conflict with his pre-existing and continuing duty as managing director of the plaintiffs. That is something which for over 200 years the courts have forbidden. The principle goes back far beyond the cases cited to me from the last century. The well-known case of ***Keech* v. *Sandford*** [(1726) Sel. Cas. t. King (Macnaghten) 175] is perhaps one of the most striking illustrations of this rule.

> "A person being possessed of a lease of... a market, devised his estate to trustee in trust for the infant; before the expiration of the term the trustee applied to the lessor for a renewal for the benefit of the infant, which he refused...there was clear proof of the refusal to renew for the benefit of the infant, on which the trustee sets a lease made to himself."

Lord King L.C. said at p. 175:

> "I must consider this as a trust for the infant; ... if a trustee, on the refusal to renew, might have a lease to himself, few trust-estates would be renewed to the cestui que use; though I do not say there is a fraud in this case, yet (the trustee) should rather have let it run out, than to have had the lease to himself. This may seem hard, that the trustee is the only person of all mankind who might not have the lease: but it is very proper that rule should be strictly pursued, and not in the least relaxed; for it is very obvious what would be the consequence of letting trustees have the lease, on refusal to renew to cestui que use."

That case shows how rigidly this rule has always been applied.

One sees in the nineteenth-century cases, of which many are quoted in Viscount Sankey's speech in the ***Regal*** case, how this principle has always been maintained. In ***Liquidators of Imperial Mercantile Credit Association* v. *Coleman*** [(1873) L.R. 6 H.L. 189], Malins, V.C., before whom the case came at first instance, said [(1871) 6 Ch. App. 558, 563]:

> "It is of the highest importance that it should be distinctly understood that it is the duty of directors of companies to use their best exertions for the benefit of those whose interests are committed to their charge, and that they are bound to disregard their own private interests whenever, a regard to them conflicts with the proper discharge of such duty."

In ***Parker* v. *MacKenna*** [(1874) 10 Ch. App. 96], James L.J. said, at p. 124:

> "I do not think it is necessary, but it appears to me very important, that we should concur in laying down again and again the general principle that in this court no agent in the course of his agency, in the matter of his agency, can be allowed to make any profit without the knowledge and consent of his principal; that that rule is an inflexible rule, and must be applied inexorably by this court, which is not entitled, in my judgment, to receive evidence, or suggestion, or argument as to whether the principal did or did not suffer any injury in fact by reason of the dealing of the agent;

for the safety of mankind requires that no agent shall be able to put his principal to the danger of such an inquiry as that."

In the nuclear age that last sentence may perhaps seem something of an exaggeration, but, nonetheless, it is eloquent of the strictness with which throughout the last century and indeed in the present century, courts of the highest authority have always applied this rule.

Therefore, I feel impelled to the conclusion that when the defendant embarked on this course of conduct of getting information on June 13, using that information and preparing those documents over the weekend of June 14/15 and sending them off on June 17, he was guilty of putting himself into the position in which his duty to his employers, the plaintiffs, and his own private interests conflicted and conflicted grievously. There being the fiduciary relationship I have described, it seems to me plain that it was his duty once he got this information to pass it to his employers and not to guard it for his own personal purposes and profit. He put himself into the position when his duty and his interests conflicted. As Lord Upjohn put it in ***Phipps* v. *Boardman*** [(1967) 2 A.C. 46, 127]: "It is only at this stage that any question of accountability arises."

Does accountability arise? It is said: "Well, even if there were that conflict of duty and interest, nonetheless, this was a contract with a third party in which the plaintiffs never could have had any interest because they would have never got it." That argument has been forcefully put before me by Mr. Davies.

The remarkable position then arises that if one applies the equitable doctrine upon which the plaintiffs rely to oblige the defendant to account, they will receive a benefit which, on Mr. Smettom's evidence at least, it is unlikely they would have got for themselves had the defendant complied with his duty to them. On the other hand, if the defendant is not required to account he will have made a large profit, as a result of having deliberately put himself into a position in which his duty to the plaintiffs who were employing him and his personal interests conflicted. I leave out of account the fact that he dishonestly tricked Mr. Hicks into releasing him on June 16 although Mr. Brown urged that that was another reason why equity must compel him to disgorge his profit. It is said that the plaintiffs' only remedy is to sue for damages either for breach of contract or may be for fraudulent misrepresentation. Mr. Brown has been at pains to disclaim any intention to claim damages for breach of contract save on one basis only, and he has disclaimed specifically any claim for damages for fraudulent misrepresentation. Therefore, if the plaintiffs succeed, they will get a profit which they probably would not have got for themselves had the defendant fulfilled his duty. If the defendant is allowed to keep that profit he will have got something which he was able to get solely by reason of his breach of fiduciary duty to the plaintiffs.

When one looks at the way the cases have gone over the centuries it is plain that the question whether or not the benefit would have been obtained but for the breach of trust has always been treated as irrelevant. I mentioned ***Keech* v. *Sandford*** a few moments ago and this fact will also be found emphasised if one looks at some of the speeches in ***Regal (Hastings) Ltd.* v. *Gulliver (Note)*** 134 though it is true, as was pointed out to me, that if one looks at some of the language used in the speeches in *Regal* such phrases as "he must account for any benefit which he obtains in the course of and owing to his directorship" will be found.

In one sense the benefit in this case did not arise because of the defendant's directorship; indeed, the defendant would not have got this work had he remained a director. However, one must, as Lord Upjohn pointed out in ***Phipps* v. *Boardman*** look at the passages in the speeches in *Regal* having regard to the facts of that case to which those passages and those statements were directed. I think Mr. Brown was right when he said that it is the basic principle which matters. It is an over-riding principle of equity that a man must not be allowed to put himself in a position in which his fiduciary duty and his interests conflict. The variety of cases where that can happen is infinite. The fact that there has not previously been a case precisely of this nature with precisely similar facts before the courts is of no import. The facts of this case are, I think, exceptional and I hope unusual. They seem to me plainly to come within this principle.

I think that, although perhaps the expression is not entirely precise, Mr. Brown put the point well when he said that what the defendant did in May, June and July was to substitute himself as an individual for the company of which he was managing director and to which he owed a fiduciary duty. It is upon the ground I have stated that I rest my conclusion in this case. Perhaps it is permissible to say I have less reluctance in reaching that conclusion on the application of this basic principle of equity since I know that what happened was enabled to happen because a release was obtained by the defendant from a binding contractual obligation by the dishonest and untrue misrepresentations which were made to Mr. Hicks on June 16.

In my judgment, therefore, an order for an account will be issued because the defendant has made and will make his profit as a result of having allowed his interests and his duty to conflict.

I would only add that if I am wrong on this central question Mr. Brown did in the alternative advance a claim for damages - this was the only claim for damages advanced - for the plaintiffs' loss of the opportunity to get this contract. I mentioned earlier in this judgment the fact that Mr. Lacey and Mr. Smettom both said they would not - I think I can put it as high as this - have employed the plaintiffs because of their objection to this type of organisation. Therefore, it cannot be said that it is anything like certain that the plaintiffs would ever have got this contract. I accept both those witnesses as witnesses of truth. On the other hand, there was always the possibility of the plaintiffs persuading the Eastern Gas Board to change their minds. And ironically enough, it would have been the defendant's duty to try to persuade them to change their mind. It is a curious position under which he whose duty it would have been to seek to persuade them to change their mind should now say that the plaintiffs suffered no loss because he would never have succeeded in persuading them to change their mind.

In the circumstances while I do not put the chance of the Eastern Gas Board being shifted from the stand they adopted very high, nonetheless, the opportunity was there and could not be taken because the plaintiffs never knew about it owing to the defendant's conduct. I do not put the chance very high. I cannot rate it, as I am dealing with liability only, at a greater than 10 per cent chance. If I am wrong in making an order for account I should have given the plaintiffs as damages whatever would represent a 10 per cent chance.

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PREVENTION OF OPPRESSION AND MISMANAGEMENT

Foss v. *Harbottle*

(1843) 67 ER 189 : (1943) 2 Hare 461

Bill by two of the proprietors of shares in a company incorporated by Act of Parliament, on behalf of themselves and all other the proprietors of shares except the Defendents, against the five directors (three of whom had become bankrupt), and against the proprietor who was not a director, and the solicitor and architect of the company, charging the Defendents with concerting and effecting various fraudulent and illegal transactions, whereby the property of the company was misapplied, aliened and wasted; that there had ceased to be a sufficient number of qualified directors to constitute a board; that the company had no clerk or office; that in such circumstances the proprietors had no power to take the property out of the hands of the Defendents, or satisfy the liabilities or wind up the affairs of the company; praying that the Defendents might be decreed to make good to the company the losses and expenses occasioned by the acts complained of; and praying the appointment of a receiver to take and apply the property of the company in discharge of its liabilities, and secure the surplus: the Defendants demurred.

Held, that upon the facts stated, the continued existence of a board of directors *de facto* must be intended; that the possibility of convening a general meeting of proprietors capable of controlling the acts of the existing board was not excluded by the allegations of the bill; that in such circumstances there was nothing to prevent the company from obtaining redress in its corporate character in respect of the matters complained of; that therefore the Plaintiffs could not sue in a form of pleading which assumed the practical dissolution of the corporation; and that the demurrers must be allowed.

When the relation of trustee and *cestui que trust* begins, as between the projectors of public companies and such companies.

Some forms prescribed for the government of a corporation may be imperative, and others directory only.

On argument of a demurrer, facts not averred in the bill, and which might possibly have been denied by plea, if they had been averred, intended against the pleader.

The bill was filed in October 1842 by Richard Foss and Edward Starkie Turton, on behalf of themselves and all other the shareholders or proprietors of shares in the company called "The Victoria Park Company," except such of the same shareholders or proprietors of shares as were Defendants thereto, against Thomas Harbottle, Joseph Adshead, Henry Byrom, John Westhead, Richard Bealey, Joseph Denison, Thomas Bunting and Richard Lane ; and also against H. Rotton, E. Lloyd, T. Peet, J. Biggs and S. Brooks, the several assignees of Byrom, Adshead and Westhead, who had become bankrupts.

The bill stated, in effect, that in September 1835 certain persons conceived the design of associating for the purchase of about 180 acres of land, situated in the parish of Manchester, belonging to the Defendant, Joseph Denison, and others, and of enclosing and planting the

same in an ornamental and park-like manner, and erecting houses thereon with attached gardens and pleasure-grounds and selling, letting or otherwise disposing thereof; and the Defendants, Harbottle, Adshead, Byrom, Westhead, Bealey, Denison, Bunting and Lane, agreed to form a joint stock company, to consist of themselves and others, for the said purpose: that in October 1835 plans of the land, and a design for laying it out, were prepared; that, after the undertaking had been projected and agreed upon, Denison purchased a considerable portion of the said land of the other original owners with the object of reselling it at a profit, and Harbottle, Adshead, Byrom, Westhead, Bunting and Lane, and one P. Leicester, and several other persons, not member of the association, purchased the said land in parcels of Denison and the other owners, so that at the time of passing the Act of Incorporation Harbottle, Adshead, Byrom, Westhead, Bunting and Lane owned more than half of the land in question, the remainder being the property of persons who were not shareholders : that Denison and last named five Defendants made considerable profits by reselling parts of the said land at increased chief rents before the Act was passed.

The bill stated that, between September 1835 and the beginning of 1836, various preliminary steps were taken for enabling the projectors of the said company to set it on foot : that in April 1836 advertisements, describing the objects of the proposed company and the probabilities of its profitable result, were published, in which it was proposed to form the association on the principle of a tontine: that the first eight named Defendants and several other persons, subscribed for shares in the proposed company, and,among others, the Plaintiff, Foss, subscribed for two shares, and the Plaintiff, Turton, for twelve shares of £ 100 each, and signed the contract, and paid the deposit of £ 5 per share: that at a public meeting of the subscribers called in May 1836 it was resolved that the report of the provisional committee should be received, and the various suggestions therein contained be adopted, subject to the approval of the directors, who were requested to complete such purchases of land, and also such other acts as they might consider necessary for carrying the objects of the undertaking into effect; and it also resolved that Harbottle, Adshead, Byrom, Westhead and Bealey should be appointed directors, with power to do such acts as they might consider necessary or desirable for the interests of the company; and Westhead, W. Grant and J. Lees were appointed auditors, Lane architect, and Bunting solicitor: that, in order to avoid the responsibilities of an ordinary partnership, the Defendants Harbottle and others suggested to the subscribers the propriety of applying for an Act of Incorporation, which was accordingly done: that in compliance with such application, by an Act, initituled “An Act for Establishing a Company for the purpose of Laying Out and Maintaining an Ornamental Park within the Townships of Rusholme, Charlton-upon Medlock and Moss Side, in the county of Lancaster,” which received the Royal assent on the 5th of May 1837, it was enacted that certain persons named in the Act, including Harbottle, Adshead, Bealey, Westhead, Bunting and Denison and other, and all and every such other poersons or person, bodies or body politie, corporate or collegiate, as had already subscribed or should thereafter from time to time became subscribers or a subseriber to the said undertaking, and be duly admitted proprietors or a proprietor as thereinafter mentioned, and their respective sucessors, executors, administrators and assigns, should be and they were thereby united into a company for the purpose of the said Act, and should be and they were thereby declared to be one body politic and corporate by the name of “The Victoria Park Company”, and by that name should have perpetual

sucession and a common seal, and by that name should and might sue and be sued, plead or be impleaded, at law or in equity, and should and might prefer and prosecute any bill or bills of indictment or information against any person or persons who should commit any felony, misdemeaour, or other offence indictable or punishable by the laws of this realm, and should also have full power and authority to purchase and hold lands, tenements and hereditaments to them, and their successors and assigns, for the use of the said undertaking, in manner thereby directed. The bill also stated the schedule annexed to the Act, whereby the different plots of the said land, numbered from 1 to 37 were stated to have been purchased by the Victoria Park Company from the various persons whose names were therein set forth., and including the following names:-Mr. P. Leicester and others", "Mr. Lacy and another", "Mr. Lane" and "Mr. Adshead", that the land so stated to be purchased of "P. Leicester and other" was at the time of passing of the Act vested partly in P. Leicester, and partly in Westhead, Bunting and Byrom, and the land so stated to be purchased of "Mr. Lacy and another" was at the time of the passing of the Act vested partly in Mr. Lacey and Partly in Lane.

The bill stated that the purchase and sale of the said land as aforesaid was the result of an arrangement fraudulently concerted and agreed upon between Harbottle, Adshead, Byrom, Westhead, Denison, Bunting and Lane, at or after the formation of the company was agreed upon, with the object of enabling themselves to derive a profit or personal benefit from the establishment of the said company; and that the arrangment amongst the persons who were parties to the plan was that a certain number from amongst themselves should be appointed directors, and should purchase for the company the said plots of land from the persons in whom they were vested, at greatly inereased and exorbitant prices: that it was with a view to carry the arrangement into effect that Harbottle, Adshead, Byrom and Westhead procured themselves to be appointed directors, and Denison procured himself to be appointed auditor: that accordingly, after the said plots of land had become vested in the several persons named in the schedule, and before the passing of the Act, the said directors, on behalf of the company, agreed to purchase the same from the persons named in the schedule at rents or prices greatly exceeding those at which the said persons had purchased the same : that after the Act was passed Harbottle, Adshead, Byrom, Westhead and Bealey continued to act as directors of the incorporated company in the same manner as before : that Adshead continued to act as director until the 18th of July 1839, Byrom until the 2nd of December 1839, and Westhead until the 2nd of January 1840, at which dates respectively fiats in bankruptcy were issued against them and they were respectively declared bankrupts, and ceased to be qualified to act as directors, and their offices as directors became vacated.

The bill stated that upwards of 3000 shares of£100 in the capital of the company were subscribed for: that the principle of tontine was abandoned : that before 1840 calls were made, amounting, with the deposit, to £ 35 per share, the whole of which were not, however, paid by all the proprietors, but that a sum exceeding £ 35, 000 in the whole was paid.

The bill stated that, after the passing of the Act, Harbottle, Adshead, Byrom, Westhead, Bunting and Lane, with the concurrence of Denison and of Bealely, proceeded to carry into execution the design which had been formed previously to the incorporation of the compoany, of fraudulently profiting and enabling the other persons who had purchased and then held the said land, to profit by the establishment of the company and at its expense; and that the said

directors accordingly, on behalf of the company, purchased, or agreed to purchase, from themeselves, Harbottle, Adshead, Byrom and Westhead, and from Bunting and Lane, and the other persons in whom the said land was vested, the same plots of land, for estates eorresponding with those purchased by and granted to the said vendors, by the original owners thereof, charged with chief or fee-farm rents, greatly exceeding the rents payable to the persons from whom the said vendors had so purchased the same : that of some of such plots the conveyances were taken to the Victoria Park Company, by its corporate name: of others, to Harbottle, Adshead, Byrom, Westhead and Bealey, as directors in trust for the company; and others rested in agreement only, without conveyance : that by these means the company took the land, charged not only with the chief rents reserved to the orignal landowners, but also with additional rents reserved and payable to Harbottle, Adshead, Byrom, Westhead, Denison, Bunting, Lane and others: that , in further pursuance of the same fraudulent design, the said directors, after purchasing the said land for the company, applied about £27,000 of the monies in their hands, belonging to the company, in the purchase or redemption of the rents so reseved to themselvees, Harbottle, Adshead, Byrom, Westhead, Denison, Bunting, Lane and others, leaving the land subject only to the chief rent reserved to the original landowners.

The bill stated that the plans of the park were contrived and designed by Lane, in concert with Denison, the directors, and Bunting, so as to render the formation of the park the means of greatly increasing the value of certain parcels of land, partly belonging to Denison and partly to Lane, situated on the outside of the boundary line of the park, but between such boundary line and one of the lodges and entrance gates, called Oxford Lodge and Gate, erected on a small part of the same land purchased by the company: and through which entrance, and the land so permitted to be retained by Denison and Lane, one of the principal approaches to the park was to the establishment of the park, according to the plans prepared by Lane, and the same was virtually incorporated in the park, and houses erected thereon would enjoy all the advantages of the park, and plots thereof were in consequence sold by Denison and Lane for building land at enhanced prices.

The bill stated that, after the purchase of the land as aforesaid, the directors proceeded to carry into effect the design of converting the same into a park, and they accordingly erected lodges and gates, marked out with fences the different crescents, terraces, streets and ways; formed drains and sewers, and made roadways, and planted ornamental trees and shrubs; that they also caused to be erected in different parts of the park several houses and buildings, some of which only were completed; and that the directors alleged the monies expended in the roads, drains and sewers amounted to £12,000, and in the houses and buildings to £39,000, or thereabouts : that the said directors sold and let several plots of land, and also sold and let several of the houses and buildings, and received the rents and purchase - money of the same.

The bill stated that Harbottle, Denison, Bunting and Lane did not pay up their calls, but some of them retained part, and others the whole thereof ; Harbottle and Lane claiming to set off the amount to the calls against the cheif rents of the lands which they sold to the company, Bunting claiming to set off the same against the chief rents, and the costs and charges due to him from the company ; and Denison claiming to set off the amount of the calls against the

rents payable to him out of the land which he sold to persons who resold the same to the company.

The bill stated that owing to the large sums retained out of the calls, the sums appropriated by the said directors to themselves, and paid to others in reduction of the increased chief rents, and payment of such rents, and owing to their having otherwise wasted and misapplied a considerable part of the monies belonging to the company, the funds of the company which came to their hands shortly after its establishment were exhausted : that the said directors, with the privity, knowledge and concurrence of Denison, Bunting and Lane, borrowed large sums of money from their bankers upon the credit of the company: that, as a further means of raising money, the said directors, and Bunting and Lane, with the concurrence of Denison, drew, made and negotiated various bills of exchange and promissory notes; and that the said directors also caused several bonds to be executed under the corporate seal of the company for securing several sums of money to the obligees thereof : that by the middle or latter part of the year 1839 the directors, and Bunting and Lane, had come under very heavy liabilities ; the cheif rents payable by the company were greatly in arrear, and the board of directors, with the concurrence of Denison, Bunting and Lane, applied to the United Kingdom Life Assurance Company to advance the Victoria Park Company a large sum of money by way of mortgage of the lands and hereditaments comprised in the park ; but the Assurance Company were advised that the Victoria Park Company were, by the 90th section of their Act, precluded from borrowing money on mortgage, until one-half of their capital (namely £ 500,000) had been paid up, and on that ground declined to make the required loan : that the directors, finding it impossible to raise money by mortgage in legitimate manner, resorted to several contrivances for the purpose of evading the provisions of the Act, and raising money on mortgage of the property of the company, by which means several large sums of money had been charged by way of mortgage or lien upon the same: that to effect such mortgages or charges, the directors procured the persons who had contracted to sell plots of land to the company, but had not executed conveyances, to convey the same, by the direction of the board, to some other person or persons in mortgage, and afterwards to convey the equity of redemption to the directors in trust for the company : that the directors also conveyed some of the plots of land which had been conveyed to them in trust for the company to some other persons by way of mortgage, and stood possessed of the equity of redemption in trust for the company: that, for the same purpose, the board of directors caused the common seal of the company to be affixed to several conveyances of plots of land which had been conveyed to the company by their corporate name, and to the directors in trust for the company, whereby the said plots of land were expressed to be conveyed for a pretended valuable consideration to one or more of the said directors absolutely, and the said directors or director then conveyed the same to other persons on mortgage to secure sometimes monies advanced to the said directors, and by them paid over to the board in satisfaction of the consideration monies expressed to be paid for the said prior convenyances under the common seal, sometimes antecedent debts in respect of monies borrowed by the board, and sometimes monies which had been advanced by the mortgagees upon the security of the bills and notes which had been made or discounted as aforesaid : that, in other cases, the said directors and Bunting deposited the title deeds of parcels of the land and buildings of the company with the holders of such bills and notes to secure the repayment of the monies due thereon , and in

order to relieve the parties thereto : that, by the means aforesaid, the directors, with the concurrence of Denison, Bunting and Land,mortgaged, charged or otherwise incumbered the greater part of the property of the company: that many of such mortgagees and incumbrancers had notice that the said board of directors had no power under the Act to mortgage or charge the property of the company, and that the said mortgages, charges and incumbrances were fraudulent and void as against the company, but that the defendants alleged that some of the said incumbrances were so planned and contrived that the persons in whose favour they were created had no such notice.

That the said directors having exhausted every means which suggested themselves to them of raising money upon credit, or upon the security of the property and effects of the company, and being unable by those means to provide for the whole of the monies due to the holders of the said bills and notes, and the other persons to whom the said directors in the said transactions had become indebted as individuals, and to satisfy the debts which were due to the persons in whose favour the said mortgages and incumbrances had been improperly created, and in order to release themselves from the responsibility which they had personally incurred by taking conveyances or demises of parts of the said land to the said directors as individuals in trust for the company, containing covenants on their parts for payment of the reserved rents, the said directors resolved to convey and dispose of the property of the company, and they accordingly themselves executed and caused to be executed under the common seal of the company, divers conveyances, assignments and other assurances, whereby divers parts of the said lands and effects of the company were expressed to be conveyed or otherwise assured absolutely to the holders of some of the said bills and notes, and some of the said mortgagees and incumbrancers, in consideration of the monies thereby purported to be secured; and also executed, and caused to be executed under the common seal of the company, divers conveyances and assurances of other parts of the said lands to the persons who sold the same to the company, in consideration of their releasing them from the payment of the rents reserved and payable out of the said lands: that many of such conveyances had been executed by Harbottle, Adshead, Westhead and Bealey, and a few by Byrom, who had been induced to execute them by being threatened with suits for the reserved rents : that Harbottle, Adshead, Byrom, Westhead and Bealey threatened and intended to convey and assure the remaining parcels of land belonging to the company to the holders of others of the said bills and notes, and to others of the said mortgagees and incumbrancers and owners of the chief rents, in satisfaction and discharge of the said monies and rents due and to become due to them respectively.

The bill stated that, upon the bankruptcy of Byrom, Adshead and Westhead, their shares in the company became vested in the Defendants, their assignees, and that they (the bankrupts) had long since ceased to be, and were not, shareholders in the company : that the whole of the land resold by them was vested in some persons unknown to the Plaintiffs, but whose names the Defendants knew and refused to discover : that, upon the bankruptcy of Westhead, there ceased to be a sufficient number of directors of the company to constitute a board for transacting the business of the company in manner provided by the Act, and Harbottle and Bealey became the only remaining directors whose office had not become vacated, and no person or persons had been appointed to supply the vacancies in the board of

directors occasioned by such bankruptcies, and conseqnenly there never had been a properly constituted board of directors of the company since the bankruptcy of Westhead.

That Byrom, Adshead and Westhead, nevertheless, after their respective bankruptcies, executed the several absolute conveyances and other assurances of the lands and property of the company, which were so executed for the purposes and in manner aforesaid, after the directors had exhausted their means of raising money upon credit or upon the security of the property of the company.

That about the end of the year 1839, or commencement of the year 1840, the said directors discharged Brammell, the secretary of the company, and gave up the office taken by the company in Manchester, and transferred the whole or the greater part of the title-deeds, books and papers of the said company into the hands of Bunting; and from that time to the present the company had had no office of its own, but the affairs of the company had been principally conducted at the office of Bunting.

That the only parts of the land bought by the company which had not been conveyed away either absolutely or by way of mortgage, and the part of the other property and effects of the company which had not been disposed of and made away with in manner aforesaid, remained vested in, and in the order and the disposition of, Harbottle, Adshead, Byrom, Westhead, Bealey and Bunting, in whose custody or power the greater part of the books, deeds and papers belonging to the company which had not been made away with remained: that by the fraudulent acts and proceedings in the premises to which Harbottle, Adshead, Byrom, Westhead, Bealey and Bunting were parties, the property and effects of the said company had been and then were involved in almost inextricable difficulties, and if such property and effects were any longer allowed to remain in their order and disposition, the same would be in danger of being wholly dissipated and irretrievably lost : that the said company were then largely indebted to their bankers and other persons who had *bona fide* advanced money to the company, and to the builders and other persons who had executed some of the works in the park, and provided materials for the same; while, in consequence of the property of the company having been wasted and improperly disposed of by the directors, there were at present no available funds which could be applied in satisfaction of the debts of the company, and that some of the creditors of the said company had obtained judgments in actions at law brought by them against the company for the amount of their debts, on which judgments interest was daily accumulating.

The bill stated that in the present circumstances of the company, and the board of directors thereof, the proprietors of shares had no power to take the property and effects of the company out of the hands of Harbottle, Adshead, Byron, Westhead, Bealey and Bunting and they had no power to appoint directors to supply the vacancies in the board occasioned by the said bankruptcies, and the proprietors of shares in the company had no power to wind up, liquidate or settle the accounts, debts or affairs of the company, or to dissolve the company, nor had they any power to provide for and satisfy the existing engagements and liabilities of the company with a view to its continuance, and the prosecution of the undertaking for which it was established without the assistance of the court: that if a proper person were appointed by the Court to take possession of and manage the property and effects of the company, and if the company were to be repaid the amount of all losses and expenses which it had sustained

or incurred by reason of the amount of all losses and expenses which it had sustained or incurred by reason of the fraudulent and improper acts and proceedings of the Defendants in the premises, and which the Defendants, or any of them, were liable to make good to the said company, as thereinafter prayed; and if the company were decreed to take and have conveyed to them so much of the said land which was retained by Denison and Lane as aforesaid, upon paying or accounting to them for the fair value thereof at the time when the undertaking was first projected; and Denison and Lane were to pay or account to the said company for the price received by them for so much of the same land as had been sold by them, over and above what was the fair price for the same at the time the undertaking was first projected; and it the mortgages, charges, encumbrances and liens, and the said conveyances and other assurances, by means of which the property and effects of the company had been improperly incumbered and disposed of, which could be redeemed or avoided, as against the persons claiming theunder, were redeemed and set aside, and the property and effects of the company thereby affected were restored to it, and the Defendants, who had not become bankrupt, and who had not paid up, but ought to have paid up, into the joint stock capital of the company, the amounts of the several calls made by the directors on their respective shares, were to pay up the same, the lands, property and effects of the company would not only be sufficient to satisfy the whole of its existing debts and liabilities, but leave a surplus, which would enable the company to proceed with and either wholly or in part accomplish, the undertaking for which it was incorporated.

The bill stated that the Defendants concealed from the Plaintiffs, and the other shareholders in the company, who were not personally parties thereto, the several fraudulent and improper acts and proceedings of the said directors and the said other Defendants, and the Plaintiffs and the other shareholders had only recently ascertained the particulars thereof, so far as they were therein stated, and they were unable to set forth the same more particularly, the Defendants having refused to make any discovery thereof, or to allow the Plaintiffs to inspect the books, accounts or papers of the company.

The bill charged that Harbottle and Bealey, and the estates of Adshead, Byrom and Westhead, in respect of that which occurred before their said bankruptcies, and Adshead, Byrom and Westhead, as to what occurred since their said bankruptcies, were liable to refund and make good to the company the amount of the losses and expenses which it had sustained in respect of the fraudulent and improper dealings of the said directors of the company with its lands and property; that Denison, Bunting and Lane had counseled and advised the directors in their said proceedings, and had derived considerable personal benefit and advantage therefrom : that Denison, Bunting and Lane were all parties to the said fraudulent scheme planned and executed as aforesaid, by which the several plots or parcels of land in the park were purchased and resold to the said company at a profit and at a price considerably exceeding the real value of the same, and that Denison, Bunting and Lane had derived considerable profit from the increased price or chief rents made payable out of the several plots or parcels of land which were purchased and resold by them in manner aforesaid, and from the monies which were paid to them as a consideration for the reduction of the same chief rents as before mentioned.

The bill charged that several general meetings and extraordinary general meetings, and other meetings of the shareholders of the company, were duly convened and held at divers times, between the time when the company was first established and the year 1841, and particularly on or about the several days or times thereinafter mentioned (naming ten different dates, from July 1837 to December 1839), and that at such meetings false and delusive statements respecting the circumstances and prospects of the company were made by the directors to the proprietors who attended such meetings, and the truth of the several fraudulent and improper acts and proceedings therein complained of was not disclosed.

The bill charged that, under the circumstances, Denison, Bunting and Lane, having participated in and personally benefited by and concealed from the other sharebolders the several fraudulent and improper acts aforesaid, were all jointly and severally liable together, with the said directors, to make good to the company the amount of the losses and expenses which had been or might be incurred in consequence of such of the said wrongful and fraudulent acts and proceedings as they were parties or privies to : that Harbottle, Byrom, Adshead, Westhead and Bealey, respectively, had still some of the property and effects belonging to the company : that the said last-named Defendants had not paid up the calls due and payable on their respective shares; that the Plaintiffs had as yet paid only three of the calls on their shares, not having paid the remainder in consequence of learning that, owing to some misconduct of the directors, the affairs of the company were in difficulties, the cause of which difficulties the Plaintiffs had but lately, and with considerable difficulty, ascertained to have arisen from the proceedings aforesaid, but in all other respects the Plaintiffs had conformed to the provisions of the Act : that there were not any shareholders in the company who had not paid up the calls on their shares besides the Plaintiffs and the said Defendants: that the names and places of abode of the other persons who are not shareholders in the company, but are interested in or liable in respect of any of the said matters, were unknown to the Plaintiffs, and the Defendants ought to discover the same : that the number of shareholders in the company was so great, and their rights and liabilities were so subject to change and fluctuation, by death and otherwise, that it would be impossible to prosecute the suit with effect if they were all made parties thereto.

The bill charged that Bunting claimed a lien upon the documents in his possession belonging to the company for the costs of business done by him as the attorney of the company, but a great part of such business consisted of the fraudulent acts aforesaid; and that he had received out of the funds of the company divers large sums of money exceeding the amount properly due to him : that Bunting had deposited some of the deeds belonging to the company with certain bankers at Liverpool, and, among the rest, the contract executed by the Plaintiffs and the other shareholders before the Act was passed, as a security for the payment of a bill of exchange for £ 3,000, to which Bunting was individually a party, but for which he untruly pretended that company was responsible; and that the holders of such deeds threatened to sue the Plaintiffs for the said £ 3,000, as parties to the contract, on the ground that the capital was not paid up; and also that the said directors threatened to cause actions at law to be brought against the Plaintiffs, under the powers of the Act, in the name of Harbottle or Bealey, as the nominal Plaintiff on behalf of the company, for the amount of the unpaid calls on their shares.

The bill charged that Harbottle and Bealey were two directors of the company, but they respectively refused to use or allow either of their names to be used as the nominal Plaintiffs in this suit on behalf of the company; but that Harbottle was a necessary party, not only in respect of his liability, but also as a nominal Defendant on behalf of the company.

After various charges, recapitulating in terms the alleged title of the Plaintiffs to the relief and discovery sought by the prayer, the bill prayed that an account might be taken of all monies received by the Defendants, Harbottle, Adshead, Byrom, Westhead, Bealey, Denison and Lane, or any of them, for the use of the company, or which but for their willful default might have been received, and of the application thereof; also an account of the losses and expenses incurred in consequence of the said fraudulent and improper dealings of the Defendants with the monies, lands and property of the company which they or any of them were liable to make good, and that they might be respectively decreed to make good the same, including in particular the profits made by Harbottle, Denison, Bunting and Lane, by buying and reselling the said land, and the profits made by Denison and Lane out of the said land retained by them; and that Denison and Lane might be decreed to convey the residue of the said land to the company, upon payment of the fair value thereof at the time the undertaking was projected: that it might be declared that the said mortgages, charges, incumbrances and liens upon the lands and property created as aforesaid, so far as regards the Defendants who executed the same or were privy thereto, were created fraudulently and in violation of the provisions of the Act, and that Harbottle, Bealey, Denison, Bunting and Lane might be decreed to make good to the company the principal money and interest due and owing upon security of such of the mortgages, charges and liens as were still subsisting, with all costs sustained by the company in relation thereto; and that it might be declared that Harbottle, Adshead, Byrom, Westhead and Bealey, by executing the said conveyances and assurances of the land and property of the company to the said mortgages, holders of notes and bills and others, committed a fraudulent breach of trust, and that Harbottle, Adshead, Byrom, Westhead, Bealey, Denison, Bunting and Lane might be decreed to make good to the company the purchase money and rents paid by the company for such lands, and expended in building and improving the same, with interest and expenses; and that the monies so recovered from the Defendants might be applied in redeeming and repurchasing the said lands and restoring them to the company. And that inquiries might be directed to ascertain which of the mortgages and incumbrances and of the conveyances and assurances, of the lands and property of the company could be avoided and set aside as against the persons claiming the benefit thereof, and that proceedings might be taken for avoiding them accordingly. And that an account might be taken of all the property and effects of the company, and the unpaid calls sued for and recovered, and that a sufficient part of such property might be applied in liquidating the existing debts and liabilities of the company, and the residue secured for its benefits. And that, for the purposes aforesaid, a receiver might be appointed to take possession of, recover and get in the lands, property and effects of the company, and for that purpose to sue in the names Harbottle and Bealey, or otherwise, as occasion might require; and that Harbottle, Adshead, Byrom, Westhead, Bealey and Bunting might be decreed to make good to the company the purchase-money and rents paid by the company for such lands, and expended in building and improving the same, with interest and expenses; and that the moneies so recovered from the defendants might be applied in redeeming the repurchasing the

said lands and restoring them to the company. And that inquiries might be directed to ascertain which of the mortgages and incumbrances, and of the conveyances and assurances, of the lands and property of the company could be avoided and set aside as against the persons claiming the benefit thereof, and that proceedings might be taken for avoiding them accordingly. And that an account might be taken of all the property and effects of the company, and the unpaid calls sued for and recovered, and that a sufficient part of such property might be applied in liquidating the existing debts and liabilities of the company, and the residue secured for its benefit. And that, for the purposes aforesaid, a receiver might be appointed to take possession of, recover and get in the lands, property and effects of the company, and for that purpose to sue in the names of Harbottle and Bealey, or otherwise, as occasion might require Harbottle, Adshead, Bryom, Westhead, Bealey and Bunting. And that the same Defendants might be restrained by injunction from holding, receiving or intermeddling with the property and effects of the company, and from executing, or causing to be executed, under the common seal of the company, and deed or instrument conveying, assigning or disposing of the same. And that Harbottle, Denison, Bunting and Lane might be restrained from entering or distraining upon any of the said lands sold by them to or in trust for the company as aforesaid. And the Plaintiffs thereby offered to pay into Court the amount of the unpaid calls due from them to the company.

The Defendants, Harbottle, Adshead and Westhead, demurred to the bill, assigning for cause want of equity, want of parties and multifariousness; and suggesting that all the proprietors of shares in the company, the assignees of P. Leicester, and the owners of land named in the schedule to the Act, were necessary parties. The Defendant Bealey, the Defendant Denison and the Defendants Bunting and Lane also put in three several demurrers, assigning like causes.

On the part of the Defendants it was contended that the suit complaining of injuries to the corporation was wholly informal in having only some of its individual members, and not the corporation itself, before the Court; that this defect would not be cured by adding the corporation as parties Defendants, for the Plaintiffs were not entitled to represent the corporate body, even as distinguished from the Defendants and for the purpose of impeaching the transactions complained of; and the Plaintiff's bill could not therefore be sustained.

It was further argued that the Plaintiffs, if they had any ground for impeaching the conduct of the Defendants, might have used the name of the corporation; and, in that case, it would have been open to the Defendants, or to the body of directors or proprietors assuming the government of the company, to have applied to the Court for the stay of proceedings, or to prevent the use of the corporate name; and upon that application, the Court would have inquired into the alleged usurpation or abuse of authority, and determined whether the Plaintiff should be permitted to proceed. Or the suit might have been in the shape of an information by the Attorney-General to correct the alleged abuse of powers granted for public purposes. The statements of fact in the bill, it was also contended, did not support the general charges of fraud upon which the title to relief was founded. Several other points of equity, as applicable to the cases made against the several Defendants, and in respect of the suggested defects of parties, were also made, but the judgment did not turn on these points.

On the part of the plaintiff, so far as related to the point on which the decision proceeded, namely, their right to sustain the bill on behalf of themselves and the other shareholders against the Defendants, without regard to the corporate character of the body, it was argued that the company was not be treated as an ordinary corporation; that it was in fact a mere partnership, having objects of private benefit, and that it must be governed by rules analogous to those which regulated partnerships or joint stock companies, consisting of numerous persons, but not incorporated. The Act of Incorporation was intended to be beneficial to the company, and to promote the undertaking, but not to extinguish any of the rights of the proprietors *inter se*. The directors were trustees for the Plaintiffs to the extent of their shares in the company; and the fact that the company had taken the form of a corporation would not be allowed to deprive the *cestui que trusts* of a remedy against their trustees for the abuse of their powers. The Act of Incorporation, moreover, expressly exempted the proprietors of the company, or persons dealing with the company; from the necessity of adopting the form of proceeding applicable to a pure corporation; for the 74th section enabled them to sue and be sued in the name of the treasurer, or any one of the directors for the time being: the bill alleged that the two remaining directors had refused to institute the suit, and shewed, in fact, that it would be against their personal interest to do so, inasmuch as they were answerable in respect of the transactions in question; if the Plaintiffs could not, therefore, institute the suit themselves they would be remediless. The directors were made Defendants; and under the 74th clause of the Act, any one of the directors might be made the nominal representative of the company; the corporation was therefore distinctly represented in the suit. The present proceeding was, in fact, the only form in which the proprietors could now impeach the conduct of the body to whom their affairs had been intrusted. The 38th section expressly excluded any proprietor, not being a director, from interfering in the management of the business of the company on any pretence whatever. The extinction of the board of directors by the bankruptcy and consequent disqualification of three of them (sect. 67), and the want of any clerk or office, effectually prevented the fulfillment of the form which the 46th, 47th and 48th sections of the Act required, in order to the due convening of a general meeting of proprietors competent to secure the remaining property of the company, and provide for its due application.

March 25. THE VICE-CHANCELLOR (Sir James Wigram).The relief which the bill in this case seeks as against the Defendants who have demurred, is founded in several alleged grounds of complaint; of these it is only necessary that I should mention two, for the consideration of those two grounds involves the principle upon which I think all the demurrers must be determined. One ground is that the directors of the Victoria Park Company, the Defendants Harbottle, Adshead, Byrom and Bealey, have, in their character of directors, purchased their own lands of themselves for the use of the company, and have paid for them, or rather taken to themselves out of the monies of the company a price exceeding the value of such lands: the other ground is that the Defendants have raised money in a manner not authorized by their powers under their Act of Incorporation; and especially that they have mortgaged or incumbered the lands and property of the company, and applied the monies thereby raised in effect, though circuitously, to pay the price of the land which they had so bought of themselves.

I do not now express any opinion upon the question whether, leaving out of view the special form in which the Plaintiffs have proceeded in the suit, the bill alleges a case in which a Court of Equity would say that the transactions in question are to be opened or dealt with in the manner which this bill seeks that they should be; but I certainly would not be understood by anything I said during the argument to do otherwise than express my cordial concurrence in the doctrine laid down in the case of ***Hichens* v. *Congreve*** [4 Russ. 562] and other cases of that class. In ***Hichens* v. *Congreve*** property was sold to a company by persons in a fiduciary character, the conveyance reciting that £ 25,000 had been paid for the purchase; the fact being that £ 10, 000 only had been paid, £ 15,000 going into the hands of the persons to whom the purchase was entrusted. I should not be in the least degree disposed to limit the operation of that doctrine in any case in which a person projecting the formation of a company invited the public to join him in the project, on a representation that he had acquired property which was intended to be applied for the purpose of the company. I should strongly incline to hold that to be an invitation to the public to participate in the benefit of the property purchased on the terms on which the projector had aequired it. The fiduciary character of the projector would, in such a case, commence from the time when he first began to deal with the public, and would of course be controlled in equity by the representation he then made to the public. If persons, on the other hand intending to form a company, should purchase land with a view to the formation of it, and state at once that they were the owners of such land, and proposed to sell it at a price fixed, for the purposes of the company about to be formed, the transction, so far as the public are concerned, commencing with that statement, might not fall within the principle of ***Hichens* v. *Congreve***. A party may have a clear right to say: "I begin the transaction at this time; I have purchased land, no matter how or from whom, or at what price; I am willing to sell it at a certain price for a given purpose." It is not necessary that I should determine the effect to the transactions that are stated to have occurred in the present case. I make these observations only that I may not be supposed, from anything which fell from me during the argument, to entertain the slightest hesitation with regard to the application, in a proper case, of the principles I have referred to. For the preset purpose I shall assume that a case is stated entitling the company, as matters now stand, to complain of the transactions mentioned in the bill.

The Victoria Park Company is an incorporated body, and the conduct with which the Defendants are charged in this suit is an injury not to the Plaintiffs exclusively; it is an injury to the whole corporation by individuals whom the corporation entrusted with powers to be exercised only for the good of the corporation. And from the case of ***The Attorney-General* v. *Wilson*** [Cr. & Ph. 1]**,** it may be stated as undoubted law that a bill or information by a corporation will lie to be relieved in as undoubted law that a bill or information by a corporation will lie to be relieved in respect of injuries which the corporation has suffered at the hands of persons standing in the situation of the directors upon this record. This bill, however, differs form that in ***The Attorney-General* v. *Wilson*** in this – that, instead of the corporation being formally represented as Plaintiffs, the bill in this case is brought by two individual corporators, professedly on behalf of themselves and all the other members of the coporation, except those who committed the injuries complained of - the Plaintiffs assuming to themselves the right and power in that manner to sue on behalf of and represent the corporation itself.

It was not, nor could it successfully be, argued that it was a matter of course for any individual members of a corporation thus to assume to themselves the right of suing in the name of the corporation. In law the corporation and the aggregate members of the corporation are not the same thing for purposes like this; and the only question can be whether the facts alleged in this case justify a departure from the rule which, *prima facie,* would require that the corporation should sue in its own name and in its corporate character, or in the name of someone whom the law has appointed to be its representative.

The demurrers are – first, of three of the directors of the company, who are also alleged to have sold lands to the corporation under the circumstances charged; secondly, of Bealey, also a director, alleged to have made himself amenable to the jurisdiction of the Court to remedy the alleged injuries, though he was not a seller of land; thirdly, of Denison, a seller of land, in like manner alleged to be implicated in the frauds charged, though he was not a director; fourthly, of Mr. Bunting, the solicitor, and Mr. Lane, the architect of the company. These gentlemen are neither directors nor sellers of lands, but all the frauds are alleged to have been committed with their privity, and they also are in this manner sought to be implicated in them. The most convenient course will be to consider the demurrer of the three against whom the strongest case is stated; and the consideration of that case will apply to the whole.

The first objection taken in the argument for the Defendants was that the individual members of the corporation cannot in any case sue in the form in which this bill is framed. During the argument I intimated an opinion, to which, upon further consideration, I fully adhere, that the rule was much too broadly stated on the part of the Defendants. I think there are cases in which a suit might properly be so framed. Corporations like this, of a private nature, are in truth little more than private partnerships; and in cases which may easily be suggested it would be too much to hold that a society of private persons associated together in undertakings, which, though certainly beneficial to the public, are nevertheless matter of private property, are to be deprived of their civil rights, *inter se* because, in order to make their common objects more attainable, the Crown or the Legislature may have conferred upon them the benefit of a corporate character. If a case should arise of injury to a corporation by some of its members, for which no adequate remedy remained, except that of a suit by individual corporators in their private characters, and asking in such character the protection of those right to which in their corporate character they were entitled, I cannot but think that the principle so forcibly laid down by Lord Cottenham in ***Wallworth* v. *Holt*** [4 Myl. & Cr. 635] and other cases would apply, and the claims of justice would be found superior to any difficulties arising out of technical rule respecting the mode in which corporations are required to sue.

But, on the other hand, it must not be without reasons of a very urgent character that established rules of law and practices are to be departed from, rules which, though in a sense technical are founded on general principles of justice and convenience; and the question is whether a case is stated in this bill entitling the Plaintiffs to sue in their private characters.

The result of these clauses is that the directors are made the governing body, subject to the superior control of the proprietors assembled in general meetings; and as I understand the Act, the proprietors so assembled have power, due notice being given of the purpose of the meeting, to originate proceedings for any purpose within the scope of the company's powers,

as well as to control the directors in any Acts which they may have originated. There may possibly be some exceptions to this proposition, but such is the general effect of the provisions of the statute.

Now, that my opinion upon this case may be clearly understood, I will consider separately the two principal grounds of complaint to which I have adverted, with reference to a very marked distinction between them. The first ground of complaint is one which, though it might *prime facie* entitle the corporation to rescind the transactions complained of, does not absolutely and of necessity fall under the description of a void transaction. The corporation might elect to adopt those transactions, and hold the directors bound by them. In other words, the transactions admit of confirmation at the option of the corporation. The second ground of complaint may stand in a different position; I allude to the mortgaging in a manner not authorized by the power of the Act. This, being beyond the powers of the corporation, may admit of no confirmation whilst any one dissenting voice is raised against it.

On the first point it is only necessary to refer to the clauses of the Act to show that whilst the supreme governing body, the proprietors at a special general meeting assembled, retain the power of exercising the functions conferred upon them by the Act of Incorporation, it cannot be competent to individual corporators to sue in the manner proposed by the Plaintiffs on the present record. This in effect purports to be a suit by *cestui que trusts* complaining of a fraud committed or alleged to have been committed by persons in a fiduciary character. The Complaints is that those trustees have sold lands to themselves, ostensibly for the benefit of the *cestui que trusts.* The proposition I have advanced is that, although the Act should prove to be avoidable, the *cestui que trusts* may elect to confirm it. Now, who are the cestui que trusts in this case? The corporation, in a sense, is undoubtedly the *cestui que trust*; but the majority of the proprietors at a special general meeting assembled, independently of any general rules of law upon the subject, by the very terms of the incorporation in the present case, has power to bind the whole body, and every individual corporator must be taken to have come into the corporation upon the terms of being liable to be so bound. How then can this Court act in a suit constituted as this is, if it is to be assumed, for the purposes of the argument, that the powers of the body of the proprietors are still in existence, and may lawfully be exercised for a purpose like that I have suggested ? Whilst the Court may be declaring the acts complained of to be void at the suit of the present Plaintiffs, who in fact may be the only proprietors who disapprove of them, the governing body of proprietors may defeat the decree by lawfully resolving upon the confirmation of the very acts which are the subject of the suit. The very fact that the governing body of proprietors assembled at the special general meting may so bind even a reluctant minority is decisive to show that the frame of this suit cannot be sustained whilst that body retains its functions. In order then that this suit may be sustained it must be shown either that there is no such power as I have supposed remaining in the proprietors, or, at least, that all means have been resorted to and found ineffectual to set that body in motion : this latter point is nowhere suggested in the bill : there is no suggestion that an attempt has been made by any proprietor to set the body of proprietors in motion, or to procure a meeting to be convened for the purpose of revoking the acts complained of. The question then is whether this bill is so framed as of necessity to exclude the supposition that the supreme body of proprietors is now in a condition to confirm

the transactions in question; or, if those transactions are to be impeached in a Court of Justice, whether the proprietors have no power to set the corporation in motion for the purpose of vindicating its own rights.

I pause here to examine the diffuculty which is supposed by the bill to oppose itself to the body of proprietors assembling and acting at an extraordinary general meeting. The 48th section of the Act says that a certain number of proprietors may call such a meeting by means of a notice to be addressed to the board of directors, and left with the clerk or secretary, at the principal office of the company, one month before the time of meeting, or the board is not bound to notice it. The bill says that there is no board of directors properly constituted, no clerk, no principal office of the company, no power of electing more directors, and that, the appointment of the clerk being in the board of directors, no clerk can in fact now be appointed. I am certainly not prepared to go the whole length of the Plaintiff's argument founded upon the 48th section. I admit that the month required would probably be considered imperative; but is not the mode of service directory only? Could the board of directors *de facto,* for the time being, by neglecting to appoint a clerk or have a principal office, deprive the superior body, the body of proprietors, of the power which the Act gives that body over the board of directors? Would not a notice in substance, a notice for example such as the 129th section provides for in other cases, be a sufficient notice? Is not the particular form of notice which is pointed out by the 48th section a form of notice given only for the convenience of the proprietors and directors? And if an impediment should exist, and, *a fortiori*, if that impediment should exist by the misconduct of the board of directors, it would be difficult to contend with success that the powers of the corporation are to be paralyzed, because there is no clerk on whom service can be made. I require more cogent arguments then I have yet heard to satisfy me that the mode of services prescribed by the 48th section, if that were the only point in the case, is more than directory. The like observations will apply to the place of service, but, as to that, I think the case is relieved from difficulty by the fact that the business of the company is stated to be principally conducted at the office of the solicitors. In substance, the board of directors, *de facto*, whether qualified or not, carry on the business of the company at a given place, and under this Act of Parliament it is manifest that service at that place would be deemed good service on the company.

If that difficulty were removed, and the Plaintiff should say that by the death or bankruptcy of directors, and the carelessness of proprietors, (for that term must be added), the governing body has lost its power to act, I should repeat the inquiries I have before suggested, and ask whether, in such a case also, the 48th section is not directory, so far as it appears to require the refusal or neglect of the board of directors to call a general meeting, before the proprietors can by advertisement call such a meeting for themselves. Adverting to the undoubted powers conferred upon the proprietors to hold special general meetings without the consent and against the will of the board of directors, and the permanent powers which the body of proprietors must of necessity have, I am yet to be persuaded that the existence of this corporation (for without a lawful governing body it cannot usefully or practically continue) can be dependent upon the accidents which at any given moment may reduce the number of directors below three. The board of directors as I have already observed, have no power to put a *veto* upon the will of any ten proprietors who may desire to call a special general meeting;

and if ten proprietors cannot be found who are willing to call special general meeting, the Plaintiffs can scarcely contend that this suit can be sustained. At all events what is there to prevent the corporators from suing in the name of the corporation? It cannot be contended that the body of proprietors have not sufficient interest in these questions to institute a suit in the name of the corporation. The latter observation, I am aware, are little more than another mode of putting the former questions which I have suggested. I am strongly inclined to think, if it were necessary to decide there points, it could not be successfully contended that the clauses of the Act of Parliament which are referred to are anything more than directory, if it be indeed, impossible from accident to pursue the form directed by the Act. I attribute to the proprietors no power which the Act does not give them: they have the power, without the consent and against the will of the directors, of calling a meeting, and of controlling their acts; and if by any inevitable accident the prescribed form of calling a meeting should become impracticable, there is still a mode of calling it, which, upon the general principles that govern the powers of corporations, I think would be held to be sufficient for the purpose.

It is not, however, upon such considerations that I shall decide this case. The view of the case which has appeared to me conclusive is that the existence of a board of directors *de facto* is sufficiently apparent upon the statements in the bill. The bankruptcy of Westhead, the last of the three directors who became bankrupt, took place on the 2nd of January 1840: the bill alleges that he thereupon ceased to be qualified to act as director, and his office became vacated; but it does not say that he ceased to act as a director; nor, although it is said that thenceforward there was no board "properly constituted" is it alleged that there was no board *de facto* exercising the functions of directors. These, and several other statements of the bill, are pregnant with the admission of the existence of a board *de facto*. By whom was the company governed, and its affairs conducted, between the time of Westhead's bankruptcy and that of the filing of the bill in October 1842? What directors or managers of the business of the company have lent their sanction to the mortgages and other transactions complained of, as having taken place since January 1840, and by which the corporation is said or supposed to be, at least to some extent, legally bound? Whatever the bill may say of the illegal constitution of the board of directors, because the individual directors are not duly qualified, it does not anywhere suggest that there has not been during the whole period, and that there was not when the bill was filed, a board of directors *de facto*, acting in and carrying on the affairs of the corporation, and whose acting must have been acquiesced in by the body of proprietors; at least, ever since the illegal constitution of the board of directors became known, and the acts in question were discovered. But if there has been or is a board *de facto*, their acts may be valid, although the persons so acting may not have been duly qualified. The 114th section (not stated in the bill) of the Act provides that all acts, deeds and things done or executed at any meeting of the directors, by any person acting as a director of the said company, shall notwithstanding it may afterwards be discovered that there was some defect or error in the appointment of such director, or that such director was disqualified, or being an interim director, was disapproved of by an annual general meeting of proprietors, be as valid and effectual as if such person had been duly appointed and was qualified to be a director. The foundation upon which I consider the Plaintiffs can alone have a right to sue in the form of this bill must wholly fail, if there has been a governing body of directors *de facto*. There is no longer the impediment to convening a meeting of proprietors, who by their vote might direct

proceedings like the present to be taken in the name of the corporation or of a treasurer of the corporation (if that were necessary); or who, by rejecting such a proposal, would, in effect, decide that the corporation was not aggrieved by the transactions in questions. Now, since the 2nd of January 1840, there must have been three annual general meetings of the company held in July in every year, according to the provisions of the Act. These Annual general meetings can only be regularly called by the board of directors. The bill does not suggest that the requisition of the Act have not been complied with in this respects, either by omitting to call the meeting, or by calling it informally; but the bill, on the contrary, avers that several general meetings and extraordinary general meetings, and other meetings of the shareholders of the company, were duly convened and held at divers times between the time when the company was established and the year 1841; including, therefore, in this period of formality of proceeding, as well as of capacity in constitution, an entire year after Westhead's bankruptcy.

Another statement of the bill leading to the inference - the existences of an acting board – is that which avers that since the year 1839 down, in fact, to the time of filing the bill, that is, during these three years, the company has had no office of its own, but the affairs of the company have been principally conducted at the office of Mr. Bunting. Now this, as I must read it, is a direct admission that the affairs of the company have been carried on by some person. By whom then have they been carried on? The statute makes the board of directors the body by whom alone those affairs are to be ordered and conducted. There is no other person or set of persons empowered by the Act to conduct the affairs of the company; and there is no allegation in the bill that any persons, other than the board of directors originally appointed, have taken upon themselves that business. In the absence of any special allegation to the contrary I am bound to assume that the affairs of the company have been carried on by the body in whom alone the powers for that purpose were vested by the Act, namely, a board of directors.

Again the bill alleges that, since the bankruptcy of Westhead, the bankrupts have joined in executing the conveyances of the property of the company to mortgagees. It could only have been in the character of directors that they could confer any title by the conveyance; in that character the mortgagees would have required them to be parties, and it is in that character that I must assume they executed the deeds.

If the case rested here, I must of necessity assume the existence of a board of directors, and in the absence of any allegation that the board *de facto*, in whose acting the company must, upon this bill, be taken to have acquiesced, have been applied to and have refused to appoint a clerk and treasurer (if that be necessary), or take such other steps as may be necessary for calling a special general meeting, or had refused to call such special general meeting, the bill does not exclude every case which the \pleader was bound to exclude in order to justify a suit on behalf of a corporation, in a form which assumes its practical dissolution. But the bill goes on to show that special general meetings have been holden since January 1840. The bill, as I have before observed, states that several general meetings and extraordinary general meetings have been holden between the establishment of the company and the year 1841, not excluding the year 1840, which was during Westhead's disqualification, "and that at such meetings false and delusive statements respecting the

circumstances and prospects of the company were made by the said directors of the company to the proprietors who attended such meetings, and the truth of the several fraudulent and improper acts and proceedings herein complained of was not disclosed;" and the bill specifies some meetings in particular. Against the pleader I must intend that some such meetings may have been holden at a time when there was no board properly constituted, and no clerk or treasurer or principal office of the company, save such as appear by the bill to have existed; and if that were so, the whole of the case of the Plaintiffs, founded on the impracticability of calling a special general meeting, fails. Assuming then, as I am bound to do, the existence, for some time at least, of a state of things in which the company was governed by a board of directors *de facto*, some of the members of which individually disqualified, and in which, notwithstanding the want of a clerk, treasurer or office, the powers of the proprietors were called into exercise at general meetings, the question is, when did that state of things cease to exist, so as to justify the extraordinary proceeding of the Plaintiffs by this suit? The Plaintiffs have not stated by their bill any facts to show that such was not the actual state of things at the time their bill was filed, and in the absence of any statement to the contrary, I must intend that it was so.

The case of ***Preston* v. *The Grand Collier Dock Company*** was referred to as an example of a suit in the present form; but there the circumstances were in on respect parallel with the present: the object of that suit was to decide the rights or liabilities of one class of the members of the corporation against another, in respect of a matter in which the corporation itself had no power to vary the situation of either.

I have applied strictly the rule of making every intendment against the pleader in this case – that is, of intending everything to have been lawful and consistent with the constitution of the company, which is not expressly shewn on the bill to have been unlawful or inconsistent with that constitution. And I am bound to make this intendment, not only on the general rule, but also on the rules of pleading which require a Plaintiff to frame his case so distinctly and unambiguously, that the Defendant may not be embarrassed in determining on the form which his defence should assume. The bill, I cannot but observe, is framed with great care, with more than ordinary professional skill and knowledge; but the averments do not exclude that which, *prima facie*, must be taken to have been the case, that during the years 1840, 1841 and 1842 there was a governing body, that by such body the business of the company was carried on, that there was no insurmountable impediment to the exercise of the powers of the proprietors assembled in general meetings to control the affairs of the company, and that such general meetings were actually held. The continued existence of a board *de facto* is not merely not excluded by the averments. But the statements in the bill of the acts which have been done suppose, and even require, the existence of such a board. Now, if the Plaintiff had alleged that there had been no board of directors *de facto*, and had on that ground impeached the transactions complained of, the Defendants might have met the case by plea, and thereby have defended themselves from answering the bill. If it should be said that the Defendants might now have pleaded that there was a board of directors *de facto*, the answer is that they might then have been told that the fact sufficiently appeared upon the bill, and therefore they ought to have demurred. Uncertainty is a defect in pleading of which advantage may be taken by demurrer. If I were to overrule these demurrers, I might be depriving the Defendants of the

power of so protecting themselves; and that because the Plaintiff has not chosen, with due precision, to put forward that fact, which, if alleged, might have been met by plea, but which, not being so alleged, leaves the bill open to demurrer.

I must further observe that, although the bill does, with great caution, attempt to meet every case which, it was supposed, might have been fatal to it upon demurrer, yet it is by allegations of most general kind, and many of which cannot by possibility be true. It alleges the recent discovery of the acts complained of, but it gives no allegation whatsoever for the purpose of telling when or how such discovery was made, or what led to it. I am bound to give the Plaintiff, on a general demurrer, the benefit of the allegation that the matters complained of have been recently discovered, whatever the term "recently discovered" may mean; but when I look into the schedule to the Act I find that many of those matters must have been known at a very early period in the history of the company. I find also provisions of the Act requiring that books shall be kept in which all transactions shall be fully and fairly stated; and I do not find in the bill anything like a precise allegation that the production of those books would not have given the information, or that there have not been means of seeing those books at least at some time since 1835, or since the transactions in question took place, so that, in point of fact, many of the transactions might and may have been sooner known. These are observations upon which I do not found my judgment, but which I use as explaining why it is I have felt bound in favour of the Defendants to construe this bill with strictness.

The second point which relates to the charges and incumbrances alleged to have been illegally made on the property of the company is open to the reasoning which I have applied to the first point, upon the question whether, in the present case, individual members are at liberty to complain in the form adopted by this bill; for why should this anomalous form of suit be resorted to, if the powers of the corporation may be called into exercise? But this part of the case is of greater difficulty upon the merits. I follow, with entire assent, the opinion expressed by the Vice Chancellor in ***Preston* v. *The Grand Collier Dock Company***, that if a transaction be void, and not merely voidable, the corporation cannot confirm it, so as to bind a dissenting minority of its members. But that will not dispose of this question. The case made with regard to these mortgages or incumbrances is, that they were executed in violation of the provisions of the Act. The mortgagees are not Defendants to the bill, nor does the bill seek to avoid the security itself, if it could be avoided, on which I give no opinion. The bill prays inquiries with a view to proceedings being taken *aliunde* to set aside these transactions against the mortagegees. The object of this bill against the Defendants is to make them individually and personally responsible to the extent of the injury alleged to have been received by the corporation from the making of the mortgages. Whatever the case might be, if the object of the suit was to rescind these transactions, and the allegations in the bill shewed that justice could not done to the shareholders without allowing two to sue on behalf of themselves and others, very different considerations arise in a case like the present, in which the consequences only of the alleged illegal Acts are sought to be visited personally upon the directors. The money forming the consideration for the mortgages was received, and was expended in, or partly in, the transactions which are the subject of the first ground of complaint. Upon this, one question appears to me to be, whether the company could confirm

the former transactions, take the benefit of the money that has been raised, and yet, as against the directors personally, complain of the acts which they have done, by means whereof the company obtains that benefit which I suppose to have been admitted and adopted by such confirmation. I think it would not be open to the company to do this; and my opinion already expressed on the first point is that the transactions which constitute the first ground of complaint may possibly be beneficial to the company, and may be so regarded by the proprietor, and admit of confirmation. I am of opinion that this question - the question of confirmation or avoidance – cannot properly be litigated upon this record, regard being had to the existing state and powers of the corporation, and that therefore that part of the bill which seeks to visit the directors personally with the consequences of the impeached mortgages and charges, the benefit of which the company enjoys, is in the same predicament as that which relates to the other subjects of complaint. Both questions stand on the same ground, and, for the reasons which I stated in considering the former point, these demurrers must be allowed.

Shanti Prasad Jain v. *Kalinga Tubes Ltd.*

AIR 1965 SC 1535

K. N. WANCHOO, J. - These appeals are a consequence of a fight between two groups of business magnates for the control of Messrs. Kalinga Tubes Limited (hereinafter referred to as the Company). They arise out of an application under Sections 397, 398, 402 and 403 of the Indian Companies Act, No. 1 of 1956 (hereinafter referred to as the Act) made by the appellant in the High Court. Most of the facts are not seriously in dispute and it is necessary to set them out in detail in order to decide the main point raised on behalf of the appellant, namely, that the affairs of the Company were being conducted in a manner oppressive to him and his group of members.

2. The Company was floated as a private limited company on December 1, 1950 with an authorised capital of Rs. 25 lacs. Originally, the shares were held by two groups of share-holders equally, except a few shares. The Company raised a sum of Rs. 36 lacs by the issue of two series of debentures which were guaranteed by the Government of Orissa between 1952 to 1954. In 1954, the appellant was approached by Dr. Mohanty, then Secretary to Government of Orissa (Industries Department) which was naturally interested in the Company having guaranteed debentures to the tune of Rs. 36 lacs, for helping the Company which was in financial and administrative difficulties. The appellant was requested to help the Company by providing finance and by arranging loans from banks and other sources and further by providing the necessary administrative guidance. The appellant agreed to do so and consequently on July 27, 1954, an agreement was entered into between the appellant,and Patnaik and Loganatha. To this agreement, the Company was not a party. The agreement provided that the appellant would be allotted shares in the Company equal to those held by Patnaik and Loganathan after increasing the share capital of the Company. Thus, the Company would have three groups of share- holders represented by the appellant, Patnaik and Loganathan holding equal number of shares, besides a French company and one Rath, who between themselves held shares worth Rs. 4 lacs. These share- holders, however, were not party to the agreement. These three groups of share-holders would have equal number of representatives on the Board of Directors of the Company, namely, two each for the time being. The appellant also undertook to arrange for cash credit facilities to the limit of Rs. Lacs on the security of raw materials and finished goods of the Company. And finally, the appellant Jain was to be the chairman of the Company. This agreement was followed by certain resolutions passed by the Company on August 16, 1954 by which some of the terms of the agreement were substantially carried out, the authorised capital was increased to rupees one crore and the appellant was made the chairman of the Company. It may, however be noted that the resolution did not refer to the agreement in terms and no change was made in the Article of Association of the Company to bring them in conformity with all the terms of the agreement. In January 1955, Narayanswamy who had been appointed Managing Dirctor resigned and Patnaik was appointed the Managing Director. In April 1955, the Company started production. Sometime thereafter the share capital was further subscribed upto Rs. 61 lacs and the three groups, namely, the appellant Jain, Patnaik and Loganathan held one-third of the shares leaving out shares held by the French company. In September 1956, a resolution was passed by the Board of Directors referring the question of conversion of the Company to

a public limited company to a sub-committee consisting of the appellant, Loganathan and Patnaik. About the same time, an application was made to the Controller of Capital Issues for the sanction of the issue of further shares to the extent of Rs. 39 lacs out of the authorised capital of rupees one crore and for the issue of debentures to the extent of Rs. 64 lacs. In this application it was stated that the shares were intended to be issued privately to the existing share-holders and/or their nominees. In December 1956, a resolution was passed by the Board of Directors for converting the Company into a public limited company and for amending the Articles of Association in consequence at the next annual general meeting. This was necessary as the Company wanted to borrow from the Industrial Finance Corporation which however made advances only to public limited companies.On January 11, 1957, the Company was converted into a public company and the Articles of Association were amended. Even so, no attempt was made to incorporate the terms of the agreement dated July 27, 1954 in the Articles of Association so amended.

4. The question of the issue of new shares came up before a meeting of the Board of Directors on March 1, 1958, and the differences between the three groups which had already begun came to the surface at that time. The appellant proposed to the Board of Directors that the new shares should be issued to the existing share-holders as provided in S. 81 of the Act. Patnaik on the other hand proposed that a general meeting should be called for the purpose of passing a resolution for the issue of new shares and for the manner and proportion in which shares were to be offered privately to the share-holders and other persons and for such other incidental matters as provided in the section. It is apparent from the conflict between the appellant group and Patnaik and Loganathan groups in this meeting that the group of Patnaik and Loganathan did not want the appellant's group to get roughly one-third of the new shares. The fear of Patnaik in this connection was that if shares were offered privately to the existing share-holders, the appellant might get all of them, for the groups of Patnaik and Loganathan did not have the money to subscribe to the new shares if offered in the first instance to the existing share-holders. Thus if the appellant got all the new shares, his group would become the majority share-holder and would thus get control of the Company. Consequently, Patnaik put forward the resolution already referred to at the meeting of the Board of Directors on March 1, 1958 which provided for calling a general meeting for directions as to the issue of new shares, which directions it was hoped would override the provisions of S. 81 of the Act. Patnaik's resolution was passed and the appellant's proposal was outvoted for the obvious reason that the Patnaik and Loganathan groups held the majority of shares. In consequence a general meeting of share-holders was called for the purpose on March 29, 1958.

5. The appellant did not attend the meeting of March 29, 1958 though he was present by proxy. Patnaik presided at that meeting. Two resolutions were put forward at that meting, one on behalf of the appellant's group and the other on behalf of Patnaik and Loganathan groups. The appellant's resolution proposed that the new shares should be offered to the existing share-holders of the Company in the proportion of their share-holdings and the offer should remain open for a period of fifteen days with the right to accept or renounce the whole or part of the offer in their names or in the names of their nominee or nominees and if a share-holder did not accept within that period the offer should be deemed to have been declined. The second resolution on behalf of the Patnaik and Loganathan groups proposed that the new

shares should not be offered or allotted to the existing share-holders or to the public and that they should be allotted privately in the best interest of the Company at the sole discretion of the directors to such persons as might have applied or thereafter apply on the condition that at least 5 per centum of the face value of the shares applied for was paid as application money and 10 per centum of the face value was paid on allotment and the balance paid as and when called upon in accordance with the Articles of Association of the Company. As was to be expected, the resolution put forward on behalf of the appellant was lost and the resolutions put forward on behalf of Patnaik and Loganathan groups as to the allotment of new shares were passed. Thus in that meeting there was a complete breach between the three groups.

6. This was followed on April 18, 1958, by a suit by the appellant and some other share-holders of his group for a declaration that the resolutions dated March 29, 1958 were ultra vires, illegal, void and not binding on the appellant, the Company and its share-holders with a prayer for permanent injunction restraining the defendants in the suit (namely, the other two groups) and their servants and agents from giving effect to or acting in any way in pursuance of the said resolutions and further restraining each of the defendants, their servants and agents from issuing and allotting the new shares in terms of the impugned resolutions. That suit was filed in the Court of the Subordinate Judge, Cuttack. It is necessary here to refer to the details of that suit. It is enough to say that an ex parte interim injunction was obtained on the same day, restraining the Company and other defendants from issuing and allotting the new shares to persons other than the existing share-holders and giving effect to the resolutions in that regard passed at the meeting held on March 29, 1958. The Company then made an application for setting aside the ex parte interim injunction. This matter came up before the Court on May 15, 1958. At that time an offer was made on behalf of the Company that in view of the urgent necessity for funds, the Company might be permitted to issue two-thirds of the shares, keeping back one-third which would have gone to the appellant if the shares had been offered to the existing share-holders; but this was not accepted on behalf of the appellant. The hearing of the injunction matter was postponed on several dates and it appears that the Patnaik and Loganathan groups continued to call meetings of the Board of Directors on the dates fixed in the suit, and the agenda always provided for the allotment of the new shares. Eventually on July 30, 1958 the Subordinate Judge delivered judgment and vacated the injunction at about 11 a.m. A meeting of the Board of Directors was being held on the same day from 10.30 a.m. and as soon as a message was received that the injunction had been vacated the new shares were allotted to seven persons who had applied for the same along with the application money. This happened about mid-day and the return as required by the Act was duly filed with the Registrar of Companies at 12.40 p.m. The same day, an application was made at 12-40 p.m. on behalf of the appellant before the Subordinate Judge praying that the order vacating the injunction be stayed till the appellant obtained orders from the High Court where he wished to appeal. The company's lawyer, however, intimated to the Court that the shares had already been allotted. Even so, the Court passed an order staying the operation of its judgment order delivered earlier for two days. The matter was then taken in appeal to the High Court by the appellant. The appeal was dismissed in September 1958. There was a letters patent appeal following the dismissal but that was not pressed and was eventually dismissed in November 1960.

7. The case of the appellant was that the seven persons to whom the new shares were allotted were nominees or benamidars of Patnaik and Loganathan and, therefore, these groups really allotted the new shares to themselves through their benamidars. It was also alleged that these seven persons only paid 5 per centum of the share money and this showed, even though it was said that the Company was in urgent need of money, that the shares were allotted to persons who were not in a position to pay the share money in full. The appellant contended that the allotment of the new shares was made surreptitiously and deliberately with the sole idea of defeating the rights of share-holders represented by him and his group and this amounted to oppression of the minority share-holders.

8. To continue the narrative, it appears that an extraordinary general meeting of the Company was called on September 21, 1960 to consider increasing the share capital from rupees one crore on which it stood after the increase in 1958 to rupees three crores by issue of additional equity shares numbering one lac of the value of rupees one crore and issue of another one lac cumulative redeemable income-tax free preference shares of the value of rupees one crore subject to such rights and privileges attaching to such preference shares as might be specified in the new Article to be inserted in the Articles of Association. It was also intended that these new shares should be offered to outsiders (i.e., other than the existing share-holders) with a view to making the Company more broad-based. This meeting was called by a notice issued on August 25, 1960.

9. It was the calling of this meeting which led to the application under S. 397, etc., on September 14, 1960 by the appellant. It was urged in the application that this issue of new shares was in furtherance of the continuing and continuous process of oppression of the appellant and his group being the minority share-holders and was designed for the purpose of completely excluding the appellant and his group from all control in the affairs of the Company and to deprive the financial advantage to be gained by them by the issue of new shares at par and to retain such advantage exclusively to the Patnaik and Loganathan groups so that the appellant and his group might be forced to sell their holdings to the Patnaik and Loganathan groups at a nominal value. That was why the new shares were being offered to outsiders and not to the existing share-holders, the object being to offer the shares to nominees and/or benamidars of the Patnaik and Loganathan groups and to such persons who would be within their control. The result of this would be that Loganathan and Patnaik groups would acquire more than 75 per centum of the voting strength of the Company and would be in complete control of it and so gain enormous financial advantage for themselves. This would cause irreparable loss and prejudice to the rights of the appellant and his group of minority share-holders. It was alleged that this was being done by Patnaik and Loganathan groups who were in control of the majority of shares. Finally it was urged that the affairs of the Company were conducted in a manner prejudicial to the interest of the Company by Loganathan and Patnaik groups and that there was mismanagement in conducting such affairs. It was further alleged that the conduct of Loganathan and Patnaik groups towards the minority share-holders was oppressive, burdensome, harsh and wrongful and the entire manoeuvre was that these groups should be able to control over 75 per centum of the voting strength in the Company. Further it was alleged that the conduct of these groups involved a visible departure from the standard of fair dealing and violation of the conditions of fairplay

to which the appellant and his group as minority share-holders were entitled. In particular the denial to the existing share-holders to subscribe to the new shares in proportion to their respective holdings and the issue of such shares to benamidars of the Patnaik and Loganathan groups was oppressive to the appellant and his group of minority share-holders and also amounted to mismanagement of the affairs of the Company. This was also in breach and violation of the agreement dated July 27, 1954 to which the Patnaik and Loganathan groups were parties. Further it was said that although in form the Company was a public company in reality it was a partnership consisting of three groups namely, the appellant's group, and of Loganathan and Patnaik groups. The last two groups had combined together against the appellant group which had resulted in justifiable lack of confidence on the part of the appellant and his group in the conduct of the affairs of the Company by the other two groups. Such lack of confidence had been caused by lack of probity in the conduct of the affairs of the Company by these two groups, which were acting to benefit themselves personally and were not concerned with the welfare of the Company. The appellant and his group would not get any relief by calling a general meeting of the Company, and the facts and circumstances aforesaid would justify the making of a winding-up order on the ground that it was just and equitable that the Company should be wound up. Therefore, the appellant prayed for directions under S. 397 of the Act, as the winding-up of the Company which was in a prosperous condition would unfairly prejudice the appellant and other members of the minority group and redress against such oppression could be given by the High Court by making suitable directions in that behalf. The affairs of the Company were being conducted in a manner prejudicial to the interest of the Company for reasons already stated and there had been a material change in the management or control of the Company by alteration in its Board of Directors and by fraudulent changes introduced in the ownership of the Company's shares and by reason of the wrongful act and conduct of the Patnaik and Loganathan groups. The appellant, therefore, prayed for the removal of the present Board of Directors, for re-constitution of the Board of Directors with at least two permanent representatives from his group and for ensuring equal representation in the Board of the three groups of share-holders and for alterations in the Articles of Association to incorporate therein the provisions of the agreement dated July 29, 1954. The appellant also sought a declaration that the resolution passed by the Board of Directors on March 1, 1958 and at the general meeting dated March 29, 1958, were null and void and were passed in abuse of the power of Patnaik and Loganathan groups and in oppression of the minority share-holders and prayed that the said resolutions be set aside in so far as they related to the issue and allotment of 39,000 new shares. The allotment made on July 30 should be declared illegal and null and void as it was made in abuse of the powers of the Patnaik and Loganathan groups and in oppression of the minority share-holders and was not binding upon the Company, the appellant and his group. It was prayed that directions be given to sell the said 39,000 shares by the allottees to the Company payment of the amount actually paid thereon so far and the Company be permitted to offer the same to the share-holders as on July 29, 1958 in proportion to their respective share-holdings. An injunction was also prayed for restraining the Company from holding the meeting on September 21, 1960. Finally it was prayed that orders be passed for investigation into the conduct of the affairs of the Company by the Loganathan and Patnaik groups and suitable directions be made with a view to regulating the affairs of the Company in future and

if necessary an administrator of the Company be appointed for carrying out such directions as the High Court might be pleased to make for purposes of removing the oppression and the acts of misconduct and mismanagement and for regulating the conduct of the affairs of the Company. The seven persons to whom the new shares were allotted in July 1958 were also made parties and injunction was prayed for restraining them from transferring those shares.

10. The application was opposed on behalf of the Company, and its main contention was that the Company was not a party to the agreement dated July 27, 1954 and was not bound by it. It was further contended that there was no mismanagement and the Company and its affairs were not being conducted in a manner prejudicial to it. It was also contended that there was no oppression on the undisputed facts in the present case. The application was also opposed on behalf of Loganathan and Patnaik groups and their case was that they had not acted in any manner which could be said to be oppressive of the rights of the minority share-holders represented by the appellant. They also contended that the affairs of the Company were not being mismanaged nor were they being conducted prejudicially to the interest of the Company. Further the seven persons to whom the shares had been allotted on July 30, 1958 contended that they were not benamidars of the Patnaik and Loganathan groups. Their case was that they were independent persons of substance and had applied for the new shares themselves and not as benamidars of Loganathan and Patnaik groups. They denied that there was any oppression of the minority share-holders as alleged or that there was any mismanagement of the affairs of the Company or any conduct which was prejudicial to the interest of the Company. They contended that the resolutions of March 1, 1958, March 29, 1958 and July 30, 1958 were perfectly legal and proper and they were entitled to the shares which had been allotted to them.

13. We shall first take up the case under S. 397 of the Act and proceed on the assumption that a case has been made out to wind-up the Company on just and equitable grounds. This is a new provision which came for the first time in the Indian Companies Act, 1913 as S. 153-C. That section was based on S. 210 of the English Companies Act, 1948 which was introduced therein for the first time. The purpose of introducing S. 210 in the English Companies Act was to give an alternative remedy to winding up in case of mismanagement or oppression. The law always provided for winding up, in case it was just and equitable to wind up a company. However, it was being felt for sometime that though it might be just and equitable in view of the manner in which the affairs of a company were conducted to wind it up, it was not fair that the company should always be wound up for that reason, particularly when it was otherwise solvent. That is why S. 210 was introduced in the English Act to provide an alternative remedy where it was felt that though a case had been made out on the ground of just and equitable cause to wind up a company, it was not in the interest of the share-holders that the company should be wound up and that it would be better if the company was allowed to continue under such directions as the Court may consider proper to give. That is the genesis of the introduction of S. 153-C in the 1913 Act and S. 397 in the Act.

It gives a right to members of a company who comply with the conditions of S. 399 to apply to the Court for relief under S. 402 of the Act or such other relief as may be suitable in the circumstances of the case, if the affairs of a company are being conducted in a manner oppressive to any member or members including any one or more of those applying. The

Court then has power to make such orders under S. 397 read with S. 402, as it thinks fit, if it comes to the conclusion that the affairs of the company are being conducted in a manner oppressive to any member or members and that to wind up the company would unfairly prejudice such member or members, but that otherwise the facts might justify the making of a winding up order on the ground that it was just and equitable that the company should be wound up. The law, however, has not defined what is oppression for purposes of this section, and it is left to Courts to decide on the facts of each case whether there is such oppression as calls for action under this section.

15. Among the important considerations which have to be kept in view in determining the scope of S. 210, the following matters were stressed in ***Elder's*** case [1952 SC 49], as summarised at p. 394 in ***Meyer's*** case, [1954 SC 381]:

> "1. The oppression of which a petitioner complains must relate to the manner in which the affairs of the company concerned are being conducted; and the conduct complained of must be such as to oppress a minority of the members (including the petitioners) qua share-holders.
>
> 2. It follows that the oppression complained of must be shown to be brought about by a majority of members exercising as share-holders a predominant voting power in the conduct of the company's affairs.
>
> 3. Although the facts relied on by the petitioner may appear to furnish grounds for the making of a winding up order under the 'just and equitable' rules, those facts must be relevant to disclose also that the making of a winding up order would unfairly prejudice the minority members qua shareholders.
>
> 4. Although the word 'oppressive' is not defined, it is possible, by way of illustration, to fi*gur*e a situation in which majority share-holders, by an abuse of their predominant voting power, are 'treating the company and its affairs as if they were their own property' to the prejudice of the minority share-holders - and in which just and equitable grounds would exist for the making of a winding-up order… but in which the 'alternative remedy' provided by Section 210 by way of an appropriate order might well be open to the minority share-holders with a view to bringing to an end the oppressive conduct of the majority.
>
> 5. The power conferred on the Court to grant a remedy in an appropriate case appears to envisage a reasonably wide discretion vested in the Court in relation to the order sought by a complainer as the appropriate equitable alternative to a winding-up order."

19. These observations from the four cases referred to above apply to S. 397 also which is almost in the same words as S. 210 of the English Act, and the question in each case is whether the conduct of the affairs of a company by the majority shareholders was oppressive to the minority shareholders and that depends upon the facts proved in a particular case. As has already been indicated, it is not enough to show that there is just and equitable cause for winding up the company, though that must be shown as preliminary to the application of S. 397. It must further be shown that the conduct of the majority shareholders was oppressive to the minority as members and this requires that events have to be considered not in isolation but as a part of a consecutive story. There must be continuous act on the part of the majority shareholders, continuing upto the date of petition, showing that the affairs of the company

were being conducted in a manner oppressive to some part of the members. The conduct must be burdensome, harsh and wrongful and mere lack of confidence between the majority shareholders and the minority shareholders would not be enough unless the lack of confidence springs from oppression of a minority by a majority in the management of the company's affairs, and such oppression must involve at least an element of lack of probity or fair dealing to a member in the matter of his proprietary rights as a shareholder. It is in the light of these principles that we have to consider the facts in this case with reference to S. 397.

20. The main plank of the appellant's case to prove oppression is the agreement of July 27, 1954 between himself and Patnaik and Loganathan. At that time he was not a member of the Company. It is not disputed that the Company was to a party to that agreement and is thus strictly speaking not bound by its terms. But even apart from this strict legal aspect of the matter, let us see what exactly the agreement provides. At that time Patnaik and Loganathan groups held shares of the value of Rs. 21 lacs in the Company, and the main provision of the agreement is that the share capital would be increased and the appellant would be given shares of the face value of Rs. 10,50,000 so that his holding should be equal to the holdings of the other two groups. It also provides that the three groups would have an equal number of representatives on the Board of Directors and the appellant would be its Chairman. Other provision of the agreement refer to matters of detail to which it is unnecessary to refer. It will be seen, however, that there is no provision in the agreement as to what would happen if and when the share capital was actually increased beyond the increase envisaged at the time of the agreement. There is also no provision in the agreement to the effect that the Articles of Association of the private company as it then was would be amended suitably to bring the provisions of the agreement with respect to shareholding and the Board of Directors, into line with the agreement. Thus there is nothing in the agreement about the future in the matter of allotment of shares in case capital was actually increased thereafter. In this connection our attention is drawn to the fifth term of the agreement which is in these terms:-

> "Ordinary shares of the face value of Rs. 4 lacs held by the French Company (Rs. 3,75,000) held by them as heretofore, and none of the parties hereto will have any interest therin so that the shareholding in the Company of all the three parties hereto will remain equal and in the same proportion".

It is argued that the intention was that the shareholding of the three groups would remain equal for ever. We are not prepared to read this implication in this term. It was easy to provide in the agreement that whenever capital was actually increased, it would be divided equally between the three parties thereto. It the absence of such a provision we do not think that the fifth term is capable of the interpretation which is put on it on behalf of the appellant. It only deals with the shares worth Rs. 1 lacs held by the other two persons and provides that besides those shareholdings capital shares would be held equally by the three parties. Therefore, as we read the agreement we cannot come to the conclusion that if provides that if in future there was an actual increase in capital that will necessarily be share equally by the three parties.

21. However, it is said that the conduct of the three parties later on shows that when there was actual increase of capital to Rs. 61 lacs sometime after July 1954, this increase was shared equally by the three parties and further when Mr. Rath sold his holdings in the Company they were purchased equally by the three parties so much so that one odd share out

of 250 shares was held by the three parties jointly. This is undoubtedly so, and does give some colour to the argument that the three parties concerned in the agreement intended that their shareholdings should remain equal even later. But this intention cannot be said to bind the Company, much less so when the Company was not bound strictly speaking even by the express terms of the agreement. So far as the Company is concerned, it was free to dispose of shares as the directors or the shareholders in general meeting considered proper without regard to this agreement.

22. Another element came into the picture in January 1957 when the Company was converted into a public limited company. It is obvious that a public limited company was even much less bound by the agreement of July 1954 as compared to the private company. We have already pointed out that even when the Company was private its Articles of Association were not amended to bring them into line with the agreement and that shows that the agreement was only between two groups of shareholders and again with respect to the state of affairs as it was at the time of the agreement. When the Company became a public limited company and it was decided to issue new shares of the value of Rs. 39 lacs the question of allotment of these shares arose. By then some differences had developed between the three groups. The appellant wanted the shares to be allotted to the existing shareholders while the Patnaik and Loganathan groups wanted the matter to be decided by a general meeting as evidenced by what happened in the meeting of the Board of Directors dated March 1, 1958. It appears that the decision to issue new shares was taken sometime in 1958 when the Company was a private company. At that time the authorised capital was rupees one crore though only Rs. 61 lacs had been issued. The fresh issue of Rs. 39 lacs worth of shares was thus intended to bring the subscribed capital upto the limit of the authorised capital. The application to the Controller of Capital Issues was made for that purpose on September 17, 1956. At that time the intention was that the issue would be private and would be made to the existing shareholders, directors and/or their nominees. This was bound to be so as the Company was then private. As, however, the Company wanted a loan from the Industrial Finance Corporation and as that Corporation would only grant loans to a public company, the Company was converted into a public as already indicated in January 1957.

23. The contention of the appellant, however, is that when the share capital was decided to be increased by fresh issue within the limit of rupees one crore, regulation 42 of the First Schedule to the 1913 Act was in force and that regulation required that direction to the contrary as to allotment of shares should be given by the resolution sanctioning increase of share capital. This was, however, not done at the time when the authorised share capital was decided to be increased in 1954 and consequently the new shares had to be allotted to the existing shareholders under regulation 42. At that time, however, the Company was private and the shares had to be issued to the existing shareholders and no question of any direction to the contrary arose if the Company was to retain its private character. The sanction of the Controller of Capital Issues came in December 1957 when the Company had become a public limited company, and the question of allotment arose thereafter. By that time the Act (i.e., the 1956-Act) had been passed and regulation 42 of the First Schedule to the 1918-Act was no longer in force. Instead it had been replaced by S. 81 of the Act, which provides that "where at any time subsequent to the first allotment of shares in a company, it is proposed to increase

the subscribed capital of the company, by the issue of new shares, then, subject to any direction to the contrary which may be given by the company in general meeting and subject only to those directions, such new shares shall be offered to the persons who at the time of the offer are holders of equity shares of the company, in proportion as nearly as circumstances admit, to the capital paid up on those shares at that time." Further sub-s. (3), of S. 81 provides that the section shall not apply to a private company. Thus S. 81 specifically applies to public companies only and comes into play when subscribed capital (as distinct from authorised capital) has to be increased. Therefore, when the question of actually issuing new shares arose after the sanction of the Controller, regulation 42 was no loner in force as it had been repealed, and action had to be taken in accordance with S. 81 of the Act. Section 81 does not require that direction to the contrary must be given by the resolution sanctioning the increase of share capital as under regulation 42 of the First Schedule to the 1913-Act. Consequently it was open to the public company in 1958 when it proposed to increase the subscribed capital after the sanction of the Controller to act under S. 81 and this was what was done by the resolution of March 28, 1958 at the general meeting. The general meeting decided that new shares should not be issued to the existing shareholders but should be issued to others privately. The resolution of March 29, 1958 was in accordance with the law as it stood when it was passed and cannot be said to be vitiated in any way.

24. It is, however, urged that the notice for the general meeting of the 29th March, 1958 was not in accordance with S. 173, and so the proceedings of the meeting must be held to be bad. The objection was, however, not taken in the petition and we have, therefore, not permitted the appellant to raise it before us, as it is a mixed question of fact and law. We may add that, though the objection was not taken in the petition, it seems to have been urged before the appeal Court, Das, J. has dealt with it at length and we would have agreed with him if we had permitted the question to be raised. This attack on the validity of what happened on March 29, 1958 must thus fail.

25. We have already said that the public company which came into existence in 1957 was not bound by the agreement of 1954 and could offer shares to such persons as it decided to do in general meeting in accordance with S. 81. The mere fact that in the meeting of March 29, 1958 it was decided to offer shares to others and not to the existing shareholders would not therefore necessarily mean oppression of the minority shareholders. The majority shareholders were not bound to accept the view of the minority shareholders that new shares should be allotted only to the existing shareholders. It also appears that the Patnaik group was afraid at the time when the new shares were being issued that as they had no money the appellant group would take up the entire new issue and would thus obtain majority control of the Company. This they wanted to avoid and that is why the new issue was resolved in general meeting to be issued to others and not to the existing shareholders. If this was the reason why new shares were not issued to the existing shareholders it can hardly be said that the action of the majority shareholders in passing the resolution which they did on March 29, 1958 was oppressive to the minority shareholders. The matter would have been different if the seven persons to whom shares were eventually allotted in July 1958 were benamidars or stooges of the Patnaik or Loganathan group, for in that case it may be said that these two groups forming the majority in the general meeting had acted fraudulently and unfairly by

depriving the appellant of what he would have got under S. 81. But there can be no doubt that the seven persons to whom the shares were eventually allotted are respectable persons of independent means. There is nothing to show that they were stooges or benamidars of the Patnaik and Loganathan groups. The action of the majority shareholders in allotting the new shares to outsiders and not to the existing shareholders cannot therefore, in the circumstances be said to be oppressive of the appellant and his group.

26. It is true that by the beginning of 1958 there were difference between the appellant and the Patnaik and Loganathan groups and there was loss of confidence between them. But mere loss of confidence between these groups of shareholders would not come within S. 397 unless it be shown that this lack of confidence sprang from a desire to oppress the minority in the management of the Company's affairs and that there was at least an element of lack of probity and fair dealing to a member in the matter of his proprietary right as a shareholder. It cannot be said on the facts on record of this case that there was any lack of probity or fair dealing towards the appellant in the matter of his proprietary right as a share-holder. It is true that he did not get any part of the new issue but equally the Patnaik and Loganathan groups, also did not get any part of it, for there is no doubt that the persons to whom the shares were allotted eventually in July 1958 were not benamidars or stooges of the Patnik and Loganathan groups. If the new allottees were benamidars or stooges of the Lognathan and Patnaik groups there might have been lack of probity or fair dealing in allotting the shares to them. Further the allotment of shares even at par did not in our opinion seriously affect the proprietary rights of the appellant as a shareholder. It is urged that the issue of new shares at par to others would depress the value of the existing shares. But the evidence shows that by 1958 the Company which had gone into production in 1955 was making profits and there is no reason to suppose that the same rate of profit would not have continued with the expansion envisaged by the increase in share capital. Besides, as the shares of the Company were not quoted on the Stock Exchange, it is impossible to say what impact the issue of new shares had on the value of the existing shares and whether the value of existing shares was depressed, if at all, by the issue of new shares. It is not a case where new shares were issued as bonus, for the issue of bonus shares does necessarily affect the value of existing shares. But these were issued on payment of cash for the purpose of expansion. In the circumstances we cannot necessarily infer that the value of the existing shares would have been seriously affected by the issue of new shares at par. So it cannot be said that this was done in order to affect the proprietary rights of the appellant as a shareholder. The issue of new shares which was done in March and July 1958 cannot, therefore, in our opinion amount to oppression of the appellant as a minority shareholder.

27. It is, however, urged that the haste with which the new shares were issued on July 30, 1958 shows a design to harm the appellant as a minority shareholder. It is no doubt true that the shares were issued in haste. But as we have already indicated the Company was in need of money for expansion and its getting the loan from the Industrial Finance Corporation also depended upon the increase of subscribed share capital. Therefore, the haste with which the shares were allotted on July 30, 1958 cannot really be said to be a part of a design to oppress the minority. The haste became necessary because the interim injunction was vacated on that day and it was felt that if immediate action was not taken and the new shares allotted, there

might be further injunction which would further delay the issue of shares and getting the loan from the Industrial Finance Corporation. The haste, therefore, appears to have occurred because of the action taken by the appellant in bringing a suit and getting a temporary injunction. It was feared that even after the vacation of the temporary injunction the appellant would go in appeal and get another injunction from the appeal Court. This fear was justified because the Subordinate Judge's Court two hours later withheld the operation of its order vacating the temporary injunction. The haste in the particular circumstances of the case in allotment of shares cannot, therefore, lead to any inference of oppression but arose out of circumstances brought about by the appellant's conduct.

28. But it is urged that even though the Company was in urgent need of money it accepted only 5 per centum with the application and 10 per centum on allotment and that the remainder of the money did not come for a long time. Again it is true that the remainder of the money did not come for sometime. It also appears that out of the seven persons who had applied to take shares six had to take loans from the Central Bank of India Limited to pay up the remainder of the money and that a part of the new capital (i.e., Rs. 7,65,000) was not received even till the time when the application under S. 397 was made. But that again in our opinion does not necessarily lead to the inference that there was oppression by the majority shareholders of the appellant, once it is held that the seven persons to whom the new shares were allotted were not stooges or benamidars of the Patnaik and Loganathan groups. There might be reasons why those persons were not in a position to pay the entire money at once and, therefore, borrowed money from the Bank to make up the full amount of the shares taken by them. Further it appears that there was fight between the appellant group on the one side and the Patnaik and Loganathan groups on the other for the control of the Company. If the fear of Patnaik was correct that the appellant would have purchased all the shares worth Rs. 39 lacs for want of money on the part of Patnaik and Loganathan groups and would thus have obtained a dominating position in the Company, the action of the majority shareholders in preventing such domination by one group only and taking action for that purpose cannot in the circumstances by said to be oppressive of the minority shareholders. It is well to remember that if the appellant had got the entire new issue of Rs. 39 lacs because of the inability of the Patnaik and Loganathan groups to take up their two-thirds shares, the majority control would have vested in one group. But the action of the majority shareholders in issuing new shares to others and not to the existing shareholders has brought about a position where, after the issue of new shares even the Patnaik and Loganathan groups have no longer a majority and they have to carry the holders of the new shares with them in order to carry on the work of the Company. The new holders are not the stooges and benamidars of the Patnaik and Loganathan groups and, therefore, after the action taken in March and July 1958 the Company cannot be said to be dominated by any group but has become more broad-based as a public company should really be. The fact that the Patnaik and Loganathan groups may be able to get the support of the holders of new shares does not necessarily mean oppression of the appellant, for the new shareholders may support the Loganathan and Patnaik groups on the ground that such support would be for the benefit of the Company.

29. Finally it is urged that the whole object of the Patnaik and Loganathan groups was to get control over 75 per centum of shares of the Company, for a voting strength of 75 per

centum is required to pass a special resolution without which complete control of a company is impossible. Therefore, it is said that Loganathan and Patnaik groups so manoeuvred the affairs that they should be able to get over 75 per centum of the voting strength. It is urged that if the new shares had been divided equally between the three groups the Patnaik and Loganathan groups would not have been able to control over 75 per centum shares. This argument again would have some force if the new shares had been allotted to stooges and benamidars of the Patnaik and Loganathan groups. But as the shareholdings stand, after the action of March and July 1958, the position is that roughly Patnaik and Loganathan groups between themselves have got shares worth Rs. 38 lacs the appellant has got shares worth Rs. 19 lacs and shares worth Rs. 39 lacs are held by the new allottees and shares worth about Rs. 4 lacs by the French company. So unless the Patnaik and Loganathan groups are able to persuade the new allottees always to vote with them they would not be in control of over 75 per centum of shares. The argument that all this was done to give the Patnaik and Loganathan groups control over 75 per centum of shares in the company does not, therefore, appear to be well founded when we remember that the new allottees are not stooges or benamidars of these two groups. The fact that the shares were issued presumably to the friends of Patnaik and Loganathan groups is hardly of any significance in the matter of oppression, for if shares are issued privately they are bound to go to friends of the directors.

30. The case of oppression, therefore, based on the agreement of July 1954 as the sheet-anchor of the appellant's case must fail. In the first place that agreement was strictly speaking not binding even on the private company – it was much less binding on the public company when it came into existence in 1957. The agreement did not contain any specific provision as to future issue of capital. Further at the time when the agreement took place the appellant was not even a member of the private company and it was really an agreement between a non-member and two members of the Company, which would go to show that be agreement could in no circumstances bind the Company. It is true that for sometime the agreement was in the main carried out when the capital was actually increased upto Rs. 61 lacs, the appellant getting one-third of it barring the French company's shares. When, however, the Company was made into a public company, some of the terms of the agreement could not be put even in the Articles of Association of the public company. But it is said that if the Patnaik and Loganathan groups had behaved like honourable men, the agreement could still have been carried out after the Company became a public company and that these two groups did not behave honourably when they gave the go-by to the agreement completely. There is some force in the contention that Loganathan and Patnaik groups, when they were in need of the appellant, took his help; it also does appear that when the Company had turned the corner and it was felt that the appellant's help was not absolutely necessary, these two groups thought it unnecessary to carry out the spirit of the agreement (though not the terms, for the terms had nothing to do with the future increase of capital and its distribution). But can it be said that the conduct of the affairs of the company was carried on oppressively merely because these two groups which in March and July 1958 were in majority did not carry out the spirit of the agreement? We have given anxious consideration to this aspect of the matter and we feel that, though the Patnaik and Loganathan groups did take advantage of the help given by the appellant when the Company was in a difficult situation, the fact that when new issue was made on behalf of the public company, they decided to make it more broad based and issue

the shares to others and not to the existing shareholders, cannot be said to be oppressive of the then minority shareholders, namely, the appellant's group. We have already pointed out that it cannot be said to have been proved in this case that the appellant suffered in his proprietary rights as a shareholder and in these circumstances it cannot be said that the action taken in March and July 1958 in the allotment of the new shares amounted to such oppression of the appellant as would justify an order under S. 397.

31. Reference then may be made to the proposed increase of shares for which a meeting was called on September 21, 1960 and which gave further cause to the appellant to move the application which he did on September 14, 1960. In that meeting it was proposed to increase the share capital by rupees two crores, one crore of which was to be in equity shares and the other crore, in preference shares. It is said that this was part of the design to further reduce the shareholdings of the appellant in the Company so that he may be driven out of it, for after the issue of the new proposed capital the appellant's holding of equity shares would be hardly 10 per centum of the entire equity capital. In the first place, as the meeting of September 21, 1960 was never held because of the injunction obtained by the appellant, we cannot say how the new shares would have been issued and whether they would have been offered to the public for subscription to make the Company even more broad-based than it was then. If that was the intention that could hardly be called oppression of the appellant. Apart from that, we fail to see why the appellant should be driven out of the Company and should be compelled to sell his shares simply because his proportion of equity capital is only 10 per centum of the entire equity capital, for it is not in dispute that the Company is doing well and the appellant will get his dividends as any other shareholder. But if the appellant means that it is not worth his while to invest his money in a company in which he is unable to have an important – if not a controlling – voice, this shows that the real basis for the application in the present case was not the oppression of the appellant as a minority shareholder but the feeling that the appellant who hoped to get control of the Company had been thwarted by what took place in March and July 1958. If that is the real position, then it cannot be said that the Loganathan and Patnaik groups acted with lack of probity or fair dealing in thwarting the desire of the appellant to get control of the Company; nor can such conduct be said to be oppressive of a minority shareholder. The case of the appellant based on the agreement of July 27, 1954 therefore, must fail and it must be held that even if that agreement was not carried out by the Company, which was not bound by it, there can be no case of oppression of the appellant.

32. We now come to the case under S. 398. It provides that any members of a company who have rights to apply in virtue of S. 399 may complain (i) that the affairs of the company are being conducted in a manner prejudicial to the interests of the company, or (ii) that a material change has taken place in the management or control of the company and that by reason of such change, it is likely that the affairs of the company will be conducted in a manner prejudicial to the interest of the company. On such application being made, if the Court is of opinion that the affairs of the company are being conducted as aforesaid or that by reason of any material change as aforesaid in the matter of management or control of a company, it is likely that the affairs of the company will be conducted as aforesaid, the Court may, with a view to bringing to an end or preventing the matters complained of or apprehended, make such order as it thinks fit. This section only comes into play as the

marginal note shows, when there is actual mismanagement or apprehension of mismanagement of the affairs of the company. It may be contrasted with S. 397 which deals with oppression to the minority shareholders, whether there is prejudice to the company or not. In the present case, the appellant relies on the following three circumstances to show that the affairs of the Company were being conducted in a manner prejudicial to its interests, namely –

(i) that when the new shares worth Rs. 39 lacs were issued in July 1958, only a small part of the share-money was received in the beginning;
(ii) that the Patnaik and Loganathan groups removed Rs. 7 lacs from the coffers of the company;
(iii) that the company lost the support of the appellant.

It is true that when new shares of the value of Rs. 39 lacs were issued, the Company received only 15 per centum of the share money to begin with, namely, 5 per centum with the application and 10 per centum on allotment. But the evidence shows that though there was some delay in the receipt of 85 per centum of share money, shares worth Rs. 30 lacs were fully paid up in the financial year 1959-60 and the only amount outstanding in that year was Rs. 7,65,000 (i.e. 85 per centum of shares worth Rs. 9 lacs). The slight delay in the payment of the full value of the shares cannot therefore in the circumstances be said to be so prejudicial to the interests of the Company as to call for any action under S. 398 of the Act.

33. As to the removal of Rs. 7 lacs from the coffers of the Company by the Loganathan and Patnaik groups, it does not appear from the application of the appellant that his complaint was that this sum was wrongfully removed by the two groups and there was any fraud with respect to its removal. The real complaint of the appellant in this connection appears to have been that he was entitled to one-third of this amount of Rs. 7 lacs under the agreement, and his share of this amount was not given to him. This appears from a letter written by the appellant to Patnaik on October 16, 1957 in which he asked that he should be paid his one-third share of this sum of Rs. 7 lacs with interest. It is not in dispute that the sum of Rs. 7 lacs was due from the Company to the Kalinga Industrial Development Corporation Limited and, therefore, the withdrawal of this amount from the Company by the Patnaik and Loganathan groups which controlled the Kalinga Industrial Development Corporation which was the managing agent of the Company before July 1954 cannot be said to amount to conducting the affairs of the Company prejudicially to its interest, whatever may be the rights of the appellant in the matter of getting one-third of this amount from the Loganathan and Patnaik groups. If he has any right under the agreement of July 27, 1954 in this matter he can enforce it in such way as may be open to him; but it cannot be said in the circumstances that this withdrawal from the Company was in any way prejudicial to the affairs of the Company, when it is clear that the Company owed the amount to the former managing agent.

34. The last point that has been urged in this connection is that the Company lost the support of the appellant in view of the action taken by the Patnaik and Loganathan groups in March and July 1958. Here again it is true that the appellant was dissatisfied with what had happened in March and July 1958 with regard to the allotment of shares worth Rs. 39 lacs and withdrew his support form the Company. If the Company was able to carry on without this support as it apparently was in 1958, it cannot be said that the action which resulted in the

loss of the appellant's support to the Company was necessarily prejudicial to it. It may be that the appellant was sore inasmuch as he must have felt that his assistance was taken when the Company was in need of such assistance; but later the Patnaik and Loganathan groups acted in the manner in which they did when they felt that the appellant's support was no longer necessary to the Company. But if the appellant's support was no longer necessary to the Company by 1958 the action of the Patnaik and Loganathan groups which resulted in the loss of such support cannot be said to be prejudicial to the interests of the Company. We, therefore, agree with the High Court that no case has been made out for action under S. 398 on the ground that the affairs of the Company were being conducted in a manner prejudicial to its interests.

35. Nor is there any ground for holding that because of the change which took place in the management after July 1958 it was likely that the affairs of the Company would be conducted in a manner prejudicial to its interests. The change that took place after July 1958 was that the appellant no longer remained the chairman of the Company and the Patnaik and Loganathan groups practically managed the Company without the appellant. But as the High Court has pointed out there were no facts before the Court to come to the conclusion that the change in management was likely to result in the affairs of the Company being conducted in a manner prejudicial to its interests. In this connection reliance is placed on certain matters which transpired after the application was filed on September 14, 1960. These matters however cannot be taken into account for the application has to be decided on the basis of the facts as they were when the application was made. Besides as the High Court has pointed out, it has not been shown that in view of certain actions taken by the new management without consulting the appellant, the Company was landed in any difficulty and loss of profit which would show mismanagement of its affairs.

36. Lastly it was stated in the application that accounts had not been shown to the appellant and his group and in consequence of this the appellant was not able to give full particulars of the several acts of fraud, misfeasance and other irregularities committed by the new management. But as the High Court has pointed out, the appellant asked for production of certain documents in April 1961 and those documents were made available for inspection by the appellant and were produced in C-ourt. It was for the appellant to take inspection of those documents if he so desired and the appeal Court was right in pointing out that the learned Single Judge was not correct in drawing an adverse inference against the Company that it had disobeyed the orders of the Court and had not produced the documents called for and had given no opportunity to the appellant for their inspection. It seems to us that the appeal Court was right in this view and no case has been made out even prima facie for action under this part of S. 398 of the Act.

37. The appeals, therefore, fail and are hereby dismissed.

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Rajahmundry Electric Supply Corporation Ltd. v. *A. Nageshwara Rao*

AIR 1956 SC 213

VENKATARAMA AYYAR, J. – This appeal arises out of an application filed by the first respondent under S. 162, cls. (v) and (vi), Companies Act, for an order that the Rajahmundry Electric Supply Corporation Ltd. be wound up. The grounds on which the relief was claimed were that the affairs of the Company were being grossly mismanaged, that large amounts were owing to the Government for charges for electric energy supplied by them, that the directors had misappropriated the funds of the Company, and that the directorate which had the majority in voting strength was "riding roughshod" over the rights of the shareholders.

In the alternative, it was prayed that action might be taken under S. 153-C and appropriate orders passed to protect the rights of the shareholders. The only effective opposition to the application came from the Chairman of the Company, Appanna Ranga Rao, who contested it on the ground that it was the Vice-Chairman, Devata Ramamohanrao, who was responsible for the maladministration of the Company, that he had been removed from the directorate, and steps were being taken to call him to account, and that there was accordingly no ground either for passing an order under S. 162, or for taking action under S. 153-C.

4. On behalf of the appellant, it was firstly contended that the application is so far as it was laid under S. 153-C was not maintainable, as there was no proof that the applicant had obtained the consent of the requisite number of shareholders as provided in sub-cl. (3)(a)(i) to S. 153-C. That clause provides that a member is entitled to apply for relief only if he has obtained the consent in writing of not less than one hundred in number of the members of the company or not less than one-tenth in number of the members, whichever is less.

The first respondent stated in his application that he had obtained the consent of 80 shareholders, which was more than one-tenth of the total number of members, and had thus satisfied the condition laid down in S. 153-C, sub-cl. (3)(a)(i). To this, an objection was taken in one of the written statements filed on behalf of the respondents that out of the 80 persons who had consented to the institution of the application, 13 were not shareholders at all, and that two members had signed twice.

It was further alleged that 13 of the persons who had given their consent to the filing of the application had subsequently withdrawn their consent. In the result, excluding these 28 members, it was pleaded, the number of persons who had consented would be reduced to 52, and, therefore, the condition laid down in S. 153-C, sub-cl. (3)(a)(i) was not satisfied.

We are of opinion that this contention must, on the allegations in the statement, assuming them to be true, fail on the merits. Excluding the names of the 13 persons who are stated to be not members and the two who are stated to have signed twice, the number of members who had given consent to the institution of the application was 65.

The number of members of the Company is stated to be 603. If, therefore, 65 members consented to the application in writing, that would be sufficient to satisfy the condition laid down in S. 153-C, sub-cl. (3)(a)(i). But it is argued that as 13 of the members who had consented to the filing of the application had, subsequent to its presentation, withdrawn their

consent, it thereafter ceased to satisfy the requirements of the statute, and was no longer maintainable.

We have no hesitation in rejecting this contention. The validity of a petition must be judged on the facts as they were at the time of its presentation, and a petition which was valid when presented cannot, in the absence of a provision to that effect in the statute, cease to be maintainable by reason of events subsequent to its presentation. In our opinion, the withdrawal of consent by 13 of the members, even if true, cannot affect either the right of the applicant to proceed with the application or the jurisdiction of the court to dispose of it on its own merits.

6. It was next contended that the allegations in the application were not sufficient to support a winding up order under S. 162, and that, therefore, no action could be taken under S. 153-C. We agree with the appellant that before taking action under S. 153-C, the Court must be satisfied that circumstances exist on which an order for winding up could be made under S. 162.

The true scope of S. 153-C is that whereas prior to its enactment the Court had no option but to pass an order for winding up when the conditions mentioned in S. 162 were satisfied, it could now in exercise of the powers conferred by that section make an order for its management by the Court with a view to its being ultimately salvaged. Where, therefore, the facts proved do not make out a case for winding up under S. 162, no order could be passed under S. 153-C.

The question, therefore, to be determined is whether the facts found make out a case for passing a winding up order under S. 162. In his application the first respondent relied on S. 162, cls. (v) and (vi) for an order for winding up. Under S. 162(v), such an order could be made if the company is unable to pay its debts. It was alleged in the application that the arrears due to the Government on 25.6.1955 by way of charges for energy supplied by them amounted to Rs. 3,10,175-3-6.

But there was no evidence that the Company was unable to pay the amount and was commercially insolvent, and the learned trial Judge rightly held that S. 162(v) was inapplicable. But he was of the opinion that on the facts established it was just and equitable to make an order for winding up under S. 162(vi), and that view has been affirmed by the learned Judges on appeal.

7. It was argued for the appellant that the evidence only established that the Vice-Chairman, Devata Ramamohan Rao, who had been in effective management was guilty of misconduct, and that by itself was not a sufficient ground for making an order for winding up.

It was further argued that the words "just and equitable" in cl. (vi) must be construed 'ejusdem generis' with the matters mentioned in cls. (i) to (v), that mere misconduct of the directors was not a ground on which a winding up order could be made, and that it was a matter of internal management for which resort must be had to the other remedies provided in the Act.

The contention of the appellant is that as all the charges made in the application amounted only to misconduct on the part of the directors, and as there was no proof that the Company was unable to pay its debts, an order for winding up under S. 162 could not be made.

8. The authorities relied on by the appellant reflect the view which was at one time held in England as to the true meaning and scope of the words "just and equitable" in the provisions corresponding to S. 162(vi) of the Indian Act.

The law is thus stated in **Halsbury's *Law of England***, Third Edition, Volume 6, page 534, para 1035:

> "The words 'just and equitable' in the enactment specifying the grounds for winding up by the Court are not to be read as being 'ejusdem generis' with the preceding words of the enactment."

When once it is held that the words "just and equitable" are not to be construed 'ejusdem generis,' then whether mismanagement of directors is a ground for winding-up order under S. 162(vi) becomes a question to be decided on the facts of each case. Where nothing more is established than that the directors have misappropriated the funds of the Company, an order for winding up would not be just or equitable, because if it is a sound concern, such an order must operate harshly on the rights of the shareholders.

But if, in addition to such misconduct, circumstances exist which render it desirable in the interests of the shareholders that the Company should be wound up, there is nothing in S. 162(vi) which bars the jurisdiction of the Court to make such an order.

9. Now, the facts as found by the courts below are that the Vice-Chairman grossly mismanaged the affairs of the Company, and had drawn considerable amounts for his personal purposes, that arrear due to the Government for supply of electric energy as on 25.6.1955 was Rs. 3,10,175-3-6, that large collections had to be made, that the machinery was in a state of disrepair, that by reason of death and other causes the directorate had become greatly attenuated and "a powerful local junta was ruling the roost," and that the shareholders outside the group of the Chairman were apathetic and powerless to set matters right. On these findings, the courts below had the power to direct the winding up of the Company under S. 162(vi), and no grounds have been shown for our interfering with their order.

10. It was urged on behalf of the appellant that as the Vice-Chairman who was responsible for the mismanagement had been proved, and the present management was taking steps to set things right and to put an end to the matters complained of, there was no need to take action under S. 153-C.

But the findings of the Courts below are that the Chairman himself either actively cooperated with the Vice-Chairman in various acts of misconduct and maladministration or that he had at any rate, on his own showing abdicated the entire management to him, and that as the affairs of the Company were in a state of confusion and embarrassment, it was necessary to take action under S. 153-C. We are of opinion that the learned Judges were justified on the above findings in passing the order which they did.

11. It was also contended that the appointment of administrators in supersession of the directorate and vesting power in them to manage the Company was an interference with its

internal management. It is no doubt the law that courts will not, in general, intervene at the instance of shareholders on matters of internal administration, and will not interfere with the management of a company by its directors, so long as they are acting within the power conferred on them under the Articles of Association.

But this rule can by its very nature apply only when the company is a running concern, and it is sought to interfere with its affairs as a running concern. But when an application is presented to wind up a company, its very object is to put an end to its existence, and for that purpose to terminate its management in accordance with the Articles of Association and to vest it in the Court. In that situation, there is no scope for the rule that the Court should not interfere in matters of internal management.

And where accordingly a case had been made out for an order for winding up under S. 162, the appointment of administrators under S. 153-C cannot be attacked on the ground that it is an interference with the internal management of the affairs of the company. If a Liquidator can be appointed to manage the affairs of a company where an order for winding up is made under S. 162, administrators could also be appointed to manage its affairs, when action is taken under S. 153-C. This contention must accordingly be rejected.

12. In the result, the appeal fails and is dismissed.

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Bharat Insurance Co. Ltd. v. *Kanhaya Lal Gauba*

AIR 1935 Lah. 792

SALE, J. – The plaintiff-respondent in this case, Mr. Kanhaya Lal Gauba, is a share-holder, policy-holder and director of the Bharat Insurance Company. Among other objects of the company, as stated in the Memorandum of Association, is the object embodied in Cl. 3(d) of the Memorandum of Association, the correct construction of which forms the main subject of the action. This clause runs as follows:

> "To advance money at interest on the security of land, houses, machinery and other property situated in India and to invest money not immediately required upon such securities and Bank Deposits as may be from time to time determined."

The Board of Directors of this company consists of Lala Harkishan Lal, Chairman, Mr. Shiv Dyal, Lala Duni Chand and the plaintiff-respondent himself. Mr. Gauba alleges that a considerable portion of the assets of the company in the shape of the life insurance fund are invested in the business undertakings controlled by the Chairman. He complains that several of these investments have been made by the Director without adequate security contrary to the provisions of Cl. (d), Art. 3 of the Memorandum of Association, and he brought this action for a declaration that the defendant company is entitled to make investments only against securities specified in this clause and not against merely personal securities of the borrower, and also for a perpetual injunction against the defendant company restraining it from granting any loans to or making any investments in certain specified concerns except on proper security and with the concurrence of a valid quorum of the Board of Directors. The learned Subordinate Judge, who heard and decided the case ex parte against the company, granted the plaintiff the declaration prayed for, but, as regards the second relief; he granted a perpetual injunction against the Directors of the defendant company only restraining them from infringing the provisions relating to quorum in the Articles of Association. From this ex parte decision the defendant company has instituted this appeal.

Before dealing with the main point in this appeal, which is the correct interpretation of Cl. (d), Art. 3 of the Memorandum of Association, it is necessary to notice the contention urged by Mr. Badri Das at the outset that the cause of action disclosed in the plaint is not maintainable against the company and that Mr. Gauba, if dissatisfied with the proceedings of the Directors, should have raised the question before the general body of share-holders. The broad rule in such cases is no doubt that in all matters of internal management of a company, the company itself is the best judge of its affairs and the Court should not interfere. But here the main point involved is the interpretation of a certain clause in the Memorandum of Association relating to the application of the assets of the company. Such a question is not a matter of mere internal management. It is alleged that certain Directors whose good faith has not been questioned have misunderstood the clause in question and are in consequence acting ultra vires in their application of the funds of the company.

Under these circumstances, I have no doubt that a single member of the company can maintain a suit for a declaration as to the true construction of the article in question. I would refer in this connexion to the observations by Brice on Ultra Vires on pp. 714, 226 and 745 of

Edn. 3, which deal with the circumstances under which a single member can maintain an action against the company for acts alleged to be ultra vires. As regards the proper persons to be cited as defendants, it seems that the company itself must in any case be joined. At p. 721 of Brice, para 294, the learned author observes:

> "There does not appear to be any case where the necessity of the corporation being a party has been expressly decided; but with respect to the first class of action (that is to say actions to prevent ultra vires proceedings), the question can admit of no doubt – the relief therein claimed against the corporation itself,"

and the learned author lays it down that the corporation itself must be a party. No doubt there have been cases quoted on p. 721 where the absence of the corporation has been excused. In the present case however I am of opinion that this is essentially a case where the relief claimed in respect of the declaration must lie against the company, and I see no reason why the company could or should have been excused from being impleaded in the present action. As regards the injunction, however it will be noted that, while the relief claimed in the plaint is against the company, the lower Court has granted the injunction against the Directors only, who have not been made parties to the suit. On p. 744 of ***Brice on Ultra Vires*** (para 301-A), it is laid down that:

> "Among the defendants must appear personally or by representation all the parties concerned in objecting to the suit. Consequently there must be joined in the first place, the corporation itself; secondly, the governing body, or at least those of them who are implicated in the objectionable proceedings."

the reason assigned being that the latter are the persons who would be affected by the decree in the first instance. In this case it is clear that the Directors as the governing body are the persons mainly affected by the injunction, if issued, and, as the Directors have not been personally impleaded it is doubtful whether the injunction in the form granted by the lower Court can be maintained. In any case it is to be noted that the plaintiff has not asked the Court to pronounce upon the validity of the past acts of the Directors. He asked only that for the future the Directors should be restrained by injunction from disregarding the provisions of the Memorandum of Association regarding quorum and security. Whatever the Directors may have done in the past it is not right to assume that the Directors will not in future conduct the affairs of the company with due order and regularity and in accordance with the interpretation placed by the Court, on Cl. (d), Art. 3 of the Memorandum of Association; and I see no reason, as regards the future conduct of the Directors in this respect, to depart from the ordinary principle that the Court will not interfere in the management of a company's internal affairs. For this reason I would accept the appeal to the extent of setting aside the order of injunction against the Directors.

Turning now to the main point urged in this appeal, the interpretation of Cl. (d), Art. 3 of the Memorandum of Association, it is necessary in the first place to repeat that the plaintiff does not ask us to pronounce on the validity of the past actions of the Directors, but to give an authoritative interpretation of Cl. (d) for future guidance of the company. The lower Court has taken the view that this article "forbids the Directors to invest money and advance loans in and on personal securities." This finding is apparently based on the view that the words "such

securities" occurring in the second portion of Cl. (d) must be interpreted according to the ejusdem generis rule, to denote the same form of securities as are required for advancing money at interest under the first portion of the clause, viz., the security of "land houses and other property situated in India." In appeal Mr. Gauba does not support the application of the ejusdem generis rule to the interpretation of the word "securities" in this connexion. His contention is that the advancing of money at interest is a transaction essentially different from that of investing money. He concedes that the securities that may be required in connexion with the investing of money may be of a different kind from the securities required for advancing money at interest, but he urges that if the grant of a loan is to be included in the phrase "invest money" according to the alleged present interpretation of this clause, the first portion of Cl. (d) would be redundant. Mr. Badri Das for the company concedes that there is a distinction between a loan and an investment and that the two portions of Cl. (d) are not redundant. He urges however that the real distinction between the two portions of this clause is that the first part of the clause relates to long term investments while the second part of the clause is confined to short term investments. His view therefore is that while long term investments or advances can only be made on the security of land, houses, machinery and other property situated in India, it is open to the Directors to make short term advances under the second part of Cl. (d) upon such securities as they think fit; in other words, that there is nothing to prevent the Directors from making short term advances on personal security.

It is clear that the two portions of Cl. (d) must be read independently and without qualification of each other. If the Directors intend to advance money at interest – in other words to grant a loan – the first portion of the clause requires the security of land, houses, machinery and other property situated in India. If however the Directors intend to invest money in the sense ordinarily understood by men of business, they are at liberty to do so upon such securities as they think fit. I do not agree with Mr. Badri Das that the point of difference between these two clauses should be confined to the length of time for which the money is to be tied up, whether advanced on loans or otherwise invested. If that were the true construction of the clause, there would be no reason for the distinction clearly drawn in the clause between advancing money at interest and investing money. As Mr. Badri Das concedes, a loan is not the same thing as an investment and I am not prepared to interpret the clause as though the two terms were interchangeable. The question must be determined by the real nature of the transaction into which the Directors propose to enter. If the intention of the Directors is to make a "temporary loan" (the expression used in p. 2 relating to one of the past transactions of the Directors) it is in my view clear that the transaction would fall under the head of advancing money at interest as mentioned in the first portion of Cl. (d) and would not be an investment. Such loans can only be made on the security of land, houses, machinery and other property, situated in India. If however the Directors intend to invest money, e.g., in Government securities or other stock, the Directors have full liberty to decide whether the nature of the security for the investment is or is not adequate, without reference to the kind of security required for loans covered by the first portion of the clause.

I would therefore hold that the plaintiff is, on this interpretation, entitled to a declaration that advances of money in the nature of loans shall only be made on the security of land, houses, machinery and other property situated in India, but that, so far as the investment of

money not immediately required is concerned, the Directors have complete discretion in the matter of approving the kind of security offered. To this extent, I would modify the order of the lower Court, as to the form of the declaration. So far as the claim for injunction is concerned, I would accept the appeal and direct that the suit be dismissed. I would leave the parties to bear their own costs, throughout.

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Radharamanan (M.S.D.C.) v. *Chandrasekara Raja (M.S.D.)*

(2008) 6 SCC 750

S.B. SINHA, J. - 2. M/s Shree Bhaarathi Cotton Mills Private Limited is a company registered and incorporated under the Companies Act, 1956 ("the Act"). Out of 2,84,000 equity shares in the Company of Rs. 10 each, 2,83,999 shares are held by the first respondent and his son (the appellant herein). The remaining one share is held by M/s Visva Bharathi Textiles Private Limited, shares in which again are held equally by the first respondent and the appellant. Thus, for all intent and purport, all shares of the Company are held by the appellant and the first respondent.

3. Whereas the first respondent is the Managing Director of the Company, the appellant is the Director thereof. Indisputably, the parties are not on good terms.

4. Respondent 1 filed an application purported to be under Sections 397 and 398 of the Act alleging several acts of oppression on the part of the appellant herein before the Company Law Board, Additional Principal Bench, Chennai. The said application was registered as CP No. 2 of 2004. By reason of an order dated 16-8-2004 the Company Law Board while holding that there was no act of mala fide or oppression on the part of the appellant, opined that there exists a deadlock in the affairs of the Company. It directed the appellant to purchase 2,84,000 (*sic*) shares held by the first respondent at a value to be determined by a chartered valuer.

5. An appeal was filed thereagainst by the appellant before the High Court of Judicature at Madras under Section 10-F of the Act which was registered as CMA No. 174 of 2004.

6. By reason of the impugned judgment dated 11-10-2006 a Division Bench of the High Court dismissed the same opining that the Company Law Board could very well look into the justifiability of the situation and was, thus, right in arriving at its conclusion that there existed a deadlock situation. It was opined that in such a situation it would be impossible for both of them to pull on together as there was incompatibility between them. The High Court noticed that the appellant herein even intended to file a criminal complaint against his father, the first respondent for alleged misappropriation of a sum of Rs 8,15,000. A suit for partition, it was furthermore noticed, was pending. It was directed:

> "*77.* … However, if there is any dispute regarding the method of valuation of the shares and the ultimate valuation arrived at by the valuer, it is open for either parties to approach the Company Law Board for getting the valuation finalised. Thereupon, at the first instance, the second respondent shall purchase the shares of the petitioners, within six months from the date of finalisation of such valuation and on his failure to do so, the petitioner in CP, shall purchase the shares of the second respondent, within six months thereafter. In the event of both the alternatives failing, the purchase of shares of either the petitioner or the second respondent could be transferred to third parties depending upon the exigency. The Company Law Board is at liberty to pass such further orders under Section 402 of the Companies Act, commensurate with the views expressed by this Court, for the smooth running of the Company.

78. In view of the reasons given for deciding the aforesaid point this civil miscellaneous appeal is partly allowed by modifying the order passed by the Company Law Board. The submission made by learned counsel for the petitioner is recorded as aforesaid."

7. Mr C.A. Sundaram, learned Senior Counsel appearing on behalf of the appellant, in support of the appeal, submitted:

1. The Company Law Board was not justified in issuing the impugned direction in purported exercise of its jurisdiction under Section 402 of the Act directing him to purchase the shares of the respondent despite arriving at a finding of fact that no act of oppression has been committed by the appellant.

2. The condition precedent for exercise of such power being oppression on the part of a Director of a company being not satisfied, the impugned judgment is wholly unsustainable.

3. The High Court committed a manifest error in passing the impugned judgment in reversing the findings of fact arrived at by the Company Law Board; although no appeal therefrom had been preferred by the first respondent so as to hold that the acts of omission and commission on the part of the appellant constituted such an oppression.

4. Both the High Court as also the Company Law Board committed a serious error in granting the relief in favour of the first respondent without taking into consideration that the grant of relief shall not only be in the interest of the Company but also must have a direct nexus with the affairs of the Company and conduct of its business.

5. In any view of the matter, having regard to the prayers made by the first respondent in his application before the Company Law Board, appointment of an Additional Director would have served the purpose.

6. As the appellant does not have the necessary fund to purchase the shares of the first respondent, he could not be forced to sell his shares.

8. Mr K. Parasaran, learned Senior Counsel, appearing for the respondents, on the other hand, would contend:

1. The appellant did not raise any ground in the special leave petition that he is not in a position to purchase the shares of Respondent 1.

2. The Company being a private limited company, which is in the nature of a quasi-partnership concern, the Court should take a holistic view of the matter and so viewed the judgments of the Company Law Board as also the High Court are unassailable.

3. The appellant having not acceded to the proposal of Respondent 1 in regard to the appointment of the Additional Director, it does not lie in his mouth to say that appointment of the Additional Director would serve the purpose.

4. The Company Law Board, in exercise of its jurisdiction under Sections 397 and 398 read with Section 402 of the Companies Act has the requisite jurisdiction to direct a shareholder to sell his shares to the other, although no case for winding up of the Company has been made out or no actual oppression on the part of the Director has been proved.

9. A shareholder of a company or a Director has several remedies under the Act. Section 433 of the Act envisages filing of an application for winding up thereof, inter alia, in a case where the Company Law Board may form an opinion that it is just and equitable that the company should be wound up.

10. Section 443 of the Act provides for the powers of Company Law Board in a winding-up proceeding. Sub-section (2) thereof provides that a company may be directed to be wound up when a petition is presented for winding up on the ground that it is just and equitable. The Company Law Board may refuse to do so, if in its opinion some other remedy is available to the petitioners and that they are acting unreasonably. The applicant, thus, in a given case, when it would not be in the interest of the company to be wound up, may take recourse to other remedies available in law. Making out a case of oppression is one of them.

11. An application under Section 397 of the Act may be filed in the following circumstances:

(1) Where the affairs of the company are being conducted in the manner prejudicial to public interest; or

(2) In a manner oppressive to any member or members.

12. Sub-section (2) of Section 397 of the Act, however, provides that in the event the court is of the opinion that the company's affairs are being conducted in a manner oppressive to any member or members or furthermore held that directing winding up the company would unfairly prejudice such member or members, but the same otherwise justifies the making of a winding-up order on the ground that it is just and equitable that the company should be wound up, it may make such other or further order as may think fit and proper with a view to bringing to an end to the matters complained of.

13. Interpretation of Section 397(2) of the Act came up for consideration before a Division Bench of this Court in ***Hanuman Prasad Bagri*** **v.** ***Bagress Cereals (P) Ltd***. [(2001) 4 SCC 420]. This Court while examining the conditions laid down in the section, opined that:

> "*3*. … No case appears to have been made out that the Company's affairs are being conducted in a manner prejudicial to public interest or in a manner oppressive of any member or members. Therefore, we have to pay our attention only to the aspect that the winding up of the Company would unfairly prejudice the members of the Company who have grievance and are the applicants before the court and that otherwise the facts would justify the making of a winding-up order on the ground that it was just and equitable that the Company should be wound up. In order to be successful on this ground, the petitioners have to make out a case for winding up of the Company on just and equitable grounds. If the facts fall short of the case set out for winding up on just and equitable grounds no relief can be granted to the petitioners. On the other hand the party resisting the winding up can demonstrate that there are neither just nor equitable grounds for winding up and an order for winding up would be unjust and unfair to them."

After reviewing the decision of the High Court on the above test, this Court held that no reasons prevailed for interference with the order and thus dismissed the appeal.

14. Section 398 of the Act provides for filing of an application for the reliefs in cases of mismanagement. Section 402 provides for the powers of the Company Law Board on an application made under Section 397 or 398 of the Act which includes the power to pass any order providing for the purchase of the shares or interests of any member of the company by other member(s) thereof or by the company.

15. Ordinarily, therefore, in a case where a case of oppression has been made a ground for the purpose of invoking the jurisdiction of the Board in terms of Sections 397 and 398 of the Act, a finding of fact to that effect would be necessary to be arrived at. But, the jurisdiction of the Company Law Board to pass any other or further order in the interest of the company, if it is of the opinion, that the same would protect the interest of the company, it would not be powerless. The jurisdiction of the Company Law Board in that regard must be held to be existing having regard to the aforementioned provisions.

16. The deadlock in regard to the conduct of the business of the Company has been noticed by the Company Law Board as also the High Court. Keeping in view the fact that there are only two shareholders and two Directors and bitterness having crept in their personal relationship, the same, in our opinion, will have a direct impact in the matter of conduct of the affairs of the Company.

17. When there are two Directors, non-cooperation by one of them would result in a stalemate and in that view of the matter the Company Law Board and the High Court have rightly exercised their jurisdiction.

18. Before us, learned counsel for the parties, have referred to a large number of decisions operating in the field. We may notice the legal principle emerging from some of them.

19. In ***Shanti Prasad Jain* v. *Kalinga Tubes Ltd.*** [AIR 1965 SC 1535], this Court compared the provisions of Section 397 with Section 210 of the English Act to hold:

> "*13*. … The law always provided for winding up, in case it was just and equitable to wind up a company. However, it was being felt for some time that though it might be just and equitable in view of the manner in which the affairs of a company were conducted to wind it up, it was not fair that the company should always be wound up for that reason, particularly when it was otherwise solvent. That is why Section 210 was introduced in the English Act to provide an alternative remedy where it was felt that, though a case had been made out on the ground of just and equitable cause to wind up a company, it was not in the interest of the shareholders that the company should be wound up and that it would be better if the company was allowed to continue under such directions as the court may consider proper to give."

The Court analysed the decision in ***H.R. Harmer Ltd., In re*** [(1958) 3 All ER 689 (CA)] in the following terms: (***Shanti Prasad*** case, AIR p. 1543, para 18)

> "*18*. In ***Harmer*** case, it was held that 'the word "oppressive" meant burdensome, harsh and wrongful'. It was also held that 'the section does not purport to apply to every case in which the facts would justify the making of a winding-up order under the "just and equitable" rule, but only to those cases of that character which have in them the requisite element of oppression'. It was also held that 'the result of

applications under Section 210 in different cases must depend on the particular facts of each case, the circumstances in which oppression may arise being so infinitely various that it is impossible to define them with precision'. The circumstances must be such as to warrant the inference that 'there had been, at least, an unfair abuse of powers and an impairment of confidence in the probity with which the company's affairs are being conducted, as distinguished from mere resentment on the part of a minority at being outvoted on some issue of domestic policy'. The phrase 'oppressive to some part of the members' suggests that the conduct complained of 'should at the lowest involve a visible departure from the standards of fair dealing, and a violation of the conditions of fair play on which every shareholder who entrusts his money to a company is entitled to rely…. But, apart from this, the question of absence of mutual confidence per se between partners, or between two sets of shareholders, however, relevant to a winding up, seems to have no direct relevance to the remedy granted by Section 210. It is oppression of some part of the shareholders by the manner in which the affairs of the company are being conducted that must be averred and proved. Mere loss of confidence or pure deadlock does not come within Section 210. It is not lack of confidence between shareholders per se that brings Section 210 into play, but lack of confidence springing from oppression of a minority by a majority in the management of the company's affairs and oppression involved at least an element of lack of probity or fair dealing to a member in the matter of his proprietary right as a shareholder."

20. It is true that observations in ***Harmer*** case were held to be applicable in a case falling within the purview of Section 397 of the Act but the statement of law that it was not enough that only a just and equitable case for winding up of the company should be made out but it must also be found that conduct of the majority shareholders was oppressive to the minority members, cannot be said to be exhaustive.

21. The question came up for consideration yet again before a three-Judge Bench of this Court in ***Needle Industries (India) Ltd.*** **v.** ***Needle Industries Newey (India) Holding Ltd*** [(1981) 3 SCC 333] wherein Chandrachud, C.J. upon considering a large number of decisions of this Court as also the English Courts including ***S.P. Jain*** and ***Harmer Ltd.*** categorically held:

> "*172*. Even though the company petition fails and the appeals succeed on the finding that the holding Company has failed to make out a case of oppression, the court is not powerless to do substantial justice between the parties and place them, as nearly as it may, in the same position in which they would have been, if the meeting of May 2 were held in accordance with law."

22. The provisions of the Act *vis-à-vis* the jurisdiction of the Company Law Board must be considered having regard to the complex situation(s) which may arise in the cases before it. No hard-and-fast rule can be laid down. There cannot be any doubt whatsoever that the acts of omission and commission on the part of a member of a company should be qua the management of the company, but it is difficult to accept the proposition that the just and equitable test, which should be held to be applicable in a case for winding up of a company, is totally outside the purview of Section 397 of the Act. The function of a Company Law Board

in such matters is first to see as to how the interest of the company *vis-à-vis* its shareholders can be safeguarded. The Company Law Board must also make an endeavour to find out as to whether an order of winding up will serve the interest of the company or subvert the same. Further, if an application is filed under Section 433 of the Act or Section 397 and/or Section 398 thereof, an order of winding up may be passed, but as noticed hereinbefore, the Company Law Board in a winding-up application may refuse to do so, if any other remedy is available. The Company Law Board may not shut its doors only on sheer technicality even if it is found as of fact that unless the jurisdiction under Section 402 of the Act is exercised, there will be a complete mismanagement in regard to the affairs of the company.

23. Sections 397 and 398 of the Act empower the Company Law Board to remove oppression and mismanagement. If the consequences of refusal to exercise jurisdiction would lead to a total chaos or mismanagement of the company, would still the Company Law Board be powerless to pass appropriate orders is the question. If a literal interpretation to the provisions of Section 397 or 398 is taken recourse to, may be that would be the consequence. But jurisdiction of the Company Law Board having been couched in wide terms and as diverse reliefs can be granted by it to keep the company functioning, is it not desirable to pass an order which for all intent and purport would be beneficial to the company itself and the majority of the members? A court of law can hardly satisfy all the litigants before it. This, however, by itself would not mean that the Company Law Board would refuse to exercise its jurisdiction, although the statute confers such a power on it.

24. It is now a well-settled principle of law that the courts should lean in favour of such construction of statute whereby its jurisdiction is retained enabling it to mould the relief, subject of course, to the applicability of law in the fact situation obtaining in each case.

25. In ***Pearson Education Inc.*** **v.** ***Prentice Hall India (P) Ltd.*** [(2007) 136 Comp Cas 294 : (2006) 134 DLT 450] as regards the jurisdiction of the Company Law Board and the High Court under Sections 397/398 and 402, a learned Single Judge of the Delhi High Court held:

> "*27.* … Jurisdiction of the CLB (and ultimately of this Court in appeal) under Sections 397/398 and 402 is much wider and direction can be given even contrary to the provisions of the articles of association. It has even right to terminate, set aside or modify the contractual arrangement between the company and any person [see Sections 402(*d*) and (*e*)]. Section 397 specifically provides that once the oppression is established, the Court may, with a view to bringing to an end the matters complained of, make an order as it thinks fit. Thus, the Court has ample power to pass such orders as it thinks fit to render justice and such an order has to be reasonable. It is also an accepted principle that 'just and equitable' provision in Section 402(*g*) is an equitable supplement to the common law of the company to be found in its memorandum and articles of association."

26. In a case of this nature, where there are two shareholders and two Directors, any animosity between them not only would have come in the way of proper functioning of the Company but it would also affect the smooth management of the affairs of the Company. The parties admittedly are at loggerheads. A suit is pending regarding title of the shares of the

Company. A contention had been raised by the appellant before the Company Law Board that the first respondent having filed a wealth tax return as karta of Hindu Undivided Family, he not only has 50% shares in the Company but also 50% shares in the HUF; whereas the contention of the first respondent in that behalf is that the appellant had already taken his half-share in the joint family property and the HUF mentioned in the wealth tax return pertains to the smaller HUF which consists of himself and his daughters.

27. The first respondent is about 80 years old. Because of his old age, he is not in a position to look after the affairs of the Company. Even in the grounds of appeal before us, a contention has been raised that it was the first respondent, who is the oppressor. We have noticed hereinbefore that, rightly or wrongly, the appellant also intended to file a criminal case against the first respondent alleging that he had misappropriated a huge amount as a Director of the Company.

28. Before the Company Law Board, several grounds to establish a case of oppression had been made out:

(1) Non coopting of a third Director on the Board;
(2) Non-clearance of accumulated stocks;
(3) Surrender of the surplus power in favour of T.N. EB;
(4) Non-issue of duplicate share certificates;
(5) Non-redemption of preference shares;
(6) Non-sanctioning of increment to the staff members;
(7) Deadlock in the affairs of the Company.

29. In regard to the first ground, admittedly, A. Jayakumar, son-in-law of the first respondent being the brother-in-law of the appellant was nominated as a Director of the Company. The appellant indisputably did not agree in that behalf. However, the first respondent left it to the discretion of the Company Law Board to appoint a third Director, but we are informed at the Bar that even the same was objected to by the appellant.

30. It is in the aforementioned situation the Company Law Board has opined that such an impasse could have been removed by resorting to appointment of an additional Director. What the Board failed to notice was that when the appellant himself intended to become the Managing Director, he would like to have his own man in the Board which was not acceded to by the first respondent.

31. Surrender of surplus power in favour of T.N. EB may be a business decision but such a decision will have a direct impact on the conduct of the business. It at least shows that the parties were at loggerheads. It is in the aforementioned situation, the High Court opined:

> "The Company Law Board should have categorically held that such surrender was beneficial to the Company and the second respondent unjustifiably objected to it. Admittedly, the second respondent was not in favour of such surrender on the ground that it was required for future expansion of the factory activities. Such a plea of the second respondent is based on mere conjectures and surmises and not borne out by any proposed project for future expansion. As such the Company Law Board very well could have held that the second respondent was oppressive."

32. In relation to the non-issue of duplicate share certificates the Company Law Board opined:

> "That is why the petitioner took up the very same issue again at the Board meeting convened on 20-3-2004, after filing of the company petition. It is on record that the second respondent did not attend the Board meeting on 20-3-2004 on the ground that the subject-matter is sub judice before CLB. Thus, there is no ultimate denial of the issue of duplicate share certificates by the second respondent in favour of the petitioner."

33. The High Court, however, in this regard opined "recording this, the Company Law Board could have very well held that the second respondent was not justified in causing obstruction to the issuance of such share certificates".

34. A ground has also been taken in the memo of appeal contending:

> "The Division Bench entirely failed to appreciate that the petitioner being a whole-time Director and also being a 50% shareholder the petitioner has a right to refuse to give his consent to certain transactions if the petitioner is of the opinion that the same is not good for the business of Respondent 2 Company or that the same is against the interests of the Company. The petitioner has merely exercised his right as a whole-time Director in not agreeing to certain resolutions and that by itself neither amounts to a deadlock nor oppression."

35. We have referred to the views taken by the Company Law Board as also the High Court, not being oblivious of the objection of Mr Sundaram, that in relation to those findings, the first respondent did not prefer any appeal. Without going into the legal issue, however, we are of the opinion that the same is only evidence of the instances as to how a deadlock in the affairs of the Company was viewed. Both the Company Law Board as well as the High Court have arrived at a concurrent finding that as there was no mutual trust and confidence between the parties and, thus, it would be impossible for the Company to run the same smoothly.

36. We are not again oblivious of the observations made by this Court in ***S.P. Jain*** case that the same by itself would not be a ground for winding up; but the ground of lack of mutual trust and confidence cannot be taken into consideration in isolation. The same has to be considered having regard to large number of other factors, the cumulative effect thereof would be extremely significant to arrive at one or the other conclusion.

37. We may take notice of the fact that the appellant had made the following allegations against the first respondent in the list of dates:

> "It is respectfully submitted that Respondent 1 did not maintain proper books of minutes of meetings or attendance registers, did not allow the petitioner herein to use the Company guest house in Chennai, Respondent 1 attempted to bring in a third Director to marginalise the role of the petitioner, Respondent 1 siphoned off Rs. 8,15,000 of the Company money, Respondent 1 attempted to transfer by way of gifts properties given as collateral security to financial institutions and so on. When the petitioner herein either asserted his rights or attempted to thwart the wrongful acts of Respondent 1, Respondent 1 became abusive."

38. We may also notice that in his reply statement before the Company Law Board it was stated by the appellant:

> "5.10. The petitioner Managing Director has become quite old. In fact under the Companies Act, in case of public companies there exist sufficient safeguards to restrict appointment of Managing Directors over the age of 70 without prior permission of the Central Government. Such provisions have been thoughtfully provided considering the inherent weaknesses that will emerge out of old age. In order to continue the smooth functioning of the enterprise, it would be very much conducive if the Managing Director gracefully retires from the post and lets a much younger and still experienced person to take over the mantle of the Company. And furthermore, so considering that the younger person is the only son of the present Managing Director, it is quite natural that the takeover of the mantle that should be mooted."

It was further averred:

> "6. There has been no oppression or mismanagement as averred by the petitioner. It is a fact that the petitioner, who is the Managing Director of the Company is in a more convenient position to oppress the second respondent but on the other hand, the petitioner has been alleging the opposite, without any basis. The mere fact that one of the two Directors/shareholders decides to exercise his proprietary right as a shareholder/Director to vote for or against any resolution does not amount to deadlock in management or oppression."

39. In a case of this nature, it is necessary to take a holistic approach of the matter. What might not be permissible for the affairs of a public limited company or even a private company having large number of shareholders and Directors, may be permissible in a case of this nature where a company for all intent and purport is a quasi-partnership concern. Parliament, while enacting a statute, cannot think of all situations which may emerge in giving effect to the statutory provision. The situation obtaining in the present case in that sense is a pathetic one. Both the Company Law Board as also the High Court had no doubt that the acrimony between the parties is resulting in mismanagement of the conduct of affairs of the Company. Therefore, a conclusion as regards the deadlock in the affairs of the Company cannot be faulted with.

40. In ***Hind Overseas (P) Ltd.*** **v.** ***Raghunath Prasad Jhunjhunwalla*** [(1976) 3 SCC 259] this Court upon noticing a large number of decisions opined:

> "*37*. Section 433(*f*) under which this application has been made has to be read with Section 443(2) of the Act. Under the latter provision where the petition is presented on the ground that it is just and equitable that the Company should be wound up, the court may refuse to make an order of winding up if it is of opinion that some other remedy is available to the petitioners and that they are acting unreasonably in seeking to have the Company wound up instead of pursuing that other remedy.
>
> *38.* Again under Sections 397 and 398 of the Act there are preventive provisions in the Act as a safeguard against oppression in management. These provisions also

indicate that relief under Section 433(*f*) based on the just and equitable clause is in the nature of a last resort when other remedies are not efficacious enough to protect the general interests of the Company."

41. This Court noticed that although the Indian Companies Act is modelled on the English Companies Act, the Indian law is developing on its own lines. It was opined that the principle of "just and equitable clause" is essentially equitable consideration and may, in a given case, be superimposed on law. The Court in arriving at the said conclusion considered the decision of House of Lords in ***Ebrahimi* v. *Westbourne Galleries Ltd***. [1973 AC 360 : (1972) 2 All ER 492 (HL)] whereupon strong reliance has been placed by Mr Sundaram as also in ***Yenidje Tobacco Co. Ltd., In re*** [(1916-17) All ER Rep 1050] amongst others. What is important is not the interest of the applicant but the interest of the shareholders of the company as a whole. If such a principle is applied in a case of winding up of a company, we do not see any reason not to invoke the said principle in a case under Section 397 of the Act, subject of course to the applicability of the well-knownjudicial safeguards.

42. A similar question came up for consideration in ***Sangramsinh P. Gaekwad* v. *Shantadevi P. Gaekwad*** [(2005) 11 SCC 314] wherein this Court upon noticing a large number of decisions including ***Needle Industries (India) Ltd***. observed:

"*191*. In ***Shanti Prasad Jain*** referring to ***Elder*** case [***Elder* v. *Elder and Watson Ltd***., 1952 SC 49 : 1952 SLT 112] it was categorically held that the conduct complained of must relate to the manner of management of the affairs of the company and must be such so as to oppress a minority of the members including the petitioners qua shareholders. The Court, however, pointed out that that law, however, has not defined what oppression is for the purpose of the said section and it is left to the court to decide on the facts of each case whether there is such oppression."

It was furthermore held:

"*196*. The court in an application under Sections 397 and 398 may also look to the conduct of the parties. While enunciating the doctrine of prejudice and unfairness borne in Section 459 of the English Companies Act, the court stressed the existence of prejudice to the minority which is unfair and not just prejudice per se.

197. The court may also refuse to grant relief where the petitioner does not come to court with clean hands which may lead to a conclusion that the harm inflicted upon him was not unfair and that the relief granted should be restricted. (See ***London School of Electronics Ltd., In re*** [(1985) 3 WLR 474: (1986) 1 Ch D 211])

198. Furthermore, when the petitioners have consented to and even benefited from the company being run in a way which would normally be regarded as unfairly prejudicial to their interests or they might have shown no interest in pursuing their legitimate interest in being involved in the company. [See ***RA Noble & Sons (Clothing) Ltd., In re****,* 1983 BCLC 273]

199. In a given case the court despite holding that no case of oppression has been made out may grant such relief so as to do substantial justice between parties. * * *

201. In ***Shanti Prasad Jain*** **v.** ***Union of India*** [(1973) 75 Bom LR 778] it was held that the power of the Company Court is very wide and not restricted by any limitation contained in Section 402 thereof or otherwise."

43. It was opined that the burden to prove oppression or mismanagement is upon the applicant. The Court, however, will have to consider the entire materials on record and may not insist upon the applicant to prove each act of oppression. It was furthermore observed that an action in contravention of law may not per se be oppressive, whereas the conduct involving illegality and contravention of the Act may be suffice to warrant grant of any remedy.

44. Reliance has been placed by Mr Sundaram on ***Kilpest (P) Ltd.*** **v.** ***Shekhar Mehra*** [(1996) 10 SCC 696] which has also been noticed in ***Sangramsinh P. Gaekwad*** opining:

"*230*. … The real character of the company, as noticed hereinbefore, for the purpose of judging the dealings between the parties and the transactions which are impugned may assume significance and in such an event, the principles of quasi-partnership in a given case may be invoked.

231. The ratio of the said decision, with respect, cannot be held to be correct as a bare proposition of law, as was urged by Mr Desai, being contrary to larger Bench judgments of this Court and in particular ***Needle Industries***. It is, however, one thing to say that for the purpose of dealing with an application under Section 397 of the Companies Act, the court would not easily accept the plea of quasi-partnership but as has been held in ***Needle Industries*** the true character of the company and other relevant factors shall be considered for the purpose of grant of relief having regard to the concept of quasi-partnership."

45. Submission of Mr Sundaram that the appointment of an additional Director could be a sufficient relief which the court may grant cannot be accepted. The appellant rejected such an offer. At this stage bitterness and acrimonies between the parties have ensued.

46. In a recent decision of ***J.K. Paliwal*** **v.** ***Paliwal Steels Ltd***. [(2007) 5 Comp LJ 279 (CLB)] on the role of the Directors in terms of Sections 397 and 398, the Company Law Board held that the role of the Directors was well settled and they were the trustees of the company. It was thus opined that the Directors were required to act on behalf of the company in a fiduciary capacity and their acts and deeds have to be exercised for the benefit of the company.

47. In ***Girdhar Gopal Dalmia*** **v.** ***Bateli Tea Co. Ltd***. [(2007) 1 Comp LJ 450 : (2007) 136 Comp Cas 339 (CLB)] the Company Law Board held that once the Company Law Board gives a finding that acts of oppression have been established, winding up of the company on just and equitable grounds becomes automatic.

48. We, in the facts and circumstances of this case, are of the opinion that it is not a fit case where we should interfere with the impugned judgment in exercise of our discretionary jurisdiction under Article 136 of the Constitution of India. The appeal fails and is dismissed with costs. Counsel's fees assessed at Rs. 50,000.

* * * * *

Civil Appeal Nos. 440-441 of 2020

Tata Consultancy Services Limited v. Cyrus Investments Private Ltd.

With

Civil Appeal Nos.13-14 of 2020

Civil Appeal Nos.442-443 of 2020

Civil Appeal Nos.19-20 of 2020

Civil Appeal Nos.444-445 of 2020

Civil Appeal Nos.448-449 of 2020

Civil Appeal Nos.263-264 of 2020

Civil Appeal No.1802 of 2020

Decided on: March 26, 2021.

Equivalent Citation: (2021) 9 SCC 449

(Before S.A. Bobde, C.J. and A.S. Bopanna and V. Ramasubramanian, JJ.)

JUDGMENT

[as modified by the Order of the Supreme Court dated May 19, 2022 in M.A. No. 849 of 2021 in C.A. Nos. 440-441 of 2020, *available at:* 2022 SCC OnLine SC 901]

1. Lis in the Appeals

1.1 Tata Sons (Private) Limited has come up with two appeals in Civil Appeal Nos.1314 of 2020, challenging a final order dated 18.12.2019 passed by the National Company Law Appellate Tribunal ("NCLAT" for short) (i) holding as illegal, the proceedings of the sixth meeting of the Board of Directors of TATA Sons Limited held on 24.10.2016 in so far as it relates to the removal of Shri Cyrus Pallonji Mistry ("CPM" for short); (ii) restoring the position of CPM as the Executive Chairman of Tata Sons Limited and consequently as a Director of the Tata Companies for the rest of the tenure; (iii) declaring as illegal the appointment of someone else in the place of CPM as Executive Chairman; (iv) restraining Shri Ratan N. Tata ("RNT" for short) and the nominees of Tata Trust from taking any decision in advance; (v) restraining the Company, its Board of Directors and Shareholders from exercising the power under Article 75 of the Articles of Association against the minority members except in exceptional circumstances and in the interest of the Company; and (vi) declaring as illegal, the decision of the Registrar of Companies for changing the status of Tata Sons Limited from being a public company into a private company.

1.2 RNT has come up with two independent appeals in Civil Appeal Nos.1920 of 2020 against the same Order of the NCLAT, on similar grounds.

1.3 The trustees of two Trusts namely Sir Ratan Tata Trust and Sir Dorabji Tata Trust have come up with two independent appeals in Civil Appeal Nos.444445 of 2020, challenging the impugned order of the Appellate Tribunal. A few companies of the Tata Group, which were referred to in the course of arguments, as the operating companies or downstream companies, such as the Tata Consultancy Services Limited, the Tata Teleservices Limited and Tata Industries Limited have come up with separate appeals in Civil Appeal Nos.440441 of 2020, 442443 of 2020 and 448449 of 2020. The grievance of RNT as well as the Trustees of the two Trusts, is as regards the injunctive order of the Appellate Tribunal restraining them from taking any decision. The grievance of the three operating companies which have filed 6 Civil Appeals is that CPM has been directed to be reinstated as Director of these companies by the impugned Order, for the rest of the tenure.

1.4 The original complainants before the National Company Law Tribunal ("NCLT"for short), who initiated the proceedings under Sections 241 and 242 of the Companies Act, 2013 namely (i) Cyrus Investments Private Limited (ii) Sterling Investment Corporation Private Limited, have come up with a cross appeal in Civil Appeal No.1802 of 2020. Their grievance is that in addition to the reliefs already granted, the NCLAT ought to have also granted a direction to provide them proportionate representation on the Board of Directors of Tata Sons Limited and in all Committees formed by the Board of Directors. They have one more grievance namely that the Appellate Tribunal ought to have deleted the requirement of an affirmative Vote in the hands of select Directors under Article 121 or at least ought to have restricted the affirmative vote to matters covered by Article 121A.

1.5 In addition to C.A.Nos. 13 and 14 of 2020, Tata Sons have also come up with 2 more appeals in C.A.Nos. 263 and 264 of 2020. These appeals arise out of an order passed by NCLAT on 06 012020 in two interlocutory applications filed by the Registrar of Companies, Mumbai, seeking amendment of the final order passed by NCLAT in the main appeals. The reason why the Registrar of Companies was constrained to file 2 interlocutory applications in the disposed of appeals, was that in the final order passed on 18 122019 by NCLAT in the 2 company appeals, there were some remarks against the Registrar of Companies for having issued an amended certificate of incorporation to Tata Sons by striking off the word "Public" and inserting the word "Private". NCLAT dismissed these 2 applications by an order dated 06.01.2020, not merely holding that there were no adverse remarks against the Registrar of Companies but also giving additional reasons to justify its findings in the disposed of appeals, in the purported exercise of the power available under section 420 of the Companies Act, 2013. Therefore, Tata Sons have come up with these 2 appeals in C.A.Nos. 263 and 264 of 2020.

1.6 Thus we have on hand, 15 Civil Appeals, 14 of which are on one side, assailing the Order of NCLAT in entirety. The remaining appeal is filed by the opposite group, seeking more reliefs than what had been granted by the Tribunal.

1.7 For the purpose of easy appreciation, we shall refer to the appellants in the set of 14 Civil Appeals as "the Tata Group" or "the Appellants". We shall refer to the other group as "SP Group" (Shapoorji Pallonji Group) or "the respondents". Similarly we shall refer to Tata Sons Limited (or Tata Sons Private Limited) merely as 'Tata Sons', as there is a controversy regarding the usage of the word "Private" before the word "Limited".

2. Background of the Litigation

2.1 On 08.11.1917, Tata Sons was incorporated as a Private Limited Company under the Companies Act, 1913.

2.2 Two companies by name Cyrus Investments Private Limited and Sterling Investment Corporation Private Limited, forming part of the SP Group respectively acquired 48 preference shares and 40 equity shares of the paid-up share capital of Tata Sons, from an existing member by name Mrs. Rodabeh Sawhney. Over the years, the shareholding of SP Group in Tata Sons has grown to 18.37% of the total paid-up share capital.

2.3 The shareholding pattern of Tata Sons Limited is as follows:

(i) Shares held by two Tata Trusts	65.89%
(ii) Shares held by SP Group	18.37%
(iii) Shares held by operating Companies	12.87%
	Total 97.13%

The balance is held by RNT and a few others.

2.4 From 25.06.1980 to 15.12.2004 Shri Pallonji S. Mistry, the father of CPM was a Non-Executive Director on the Board of Tata Sons. On 10.08.2006 CPM was appointed as a Non-Executive Director on the Board.

2.5 By a Resolution of the Board of Directors of Tata Sons dated 16.03.2012, CPM was appointed as Executive Deputy Chairman for a period of five years from 01.04.2012 to 31.03.2017, subject however to the approval of the shareholders at a General Meeting. The General Meeting gave its approval on 01.08.2012.

2.6 By a Resolution dated 18.12.2012, the Board of Directors of Tata Sons redesignated CPM as its Executive Chairman with effect from 29.12.2012, even while designating RNT as Chairman Emeritus.

2.7 By a Resolution passed on 24.10.2016, the Board of Directors of Tata Sons replaced CPM with RNT as the interim Non Executive Chairman. It is relevant to note that CPM was replaced only from the post of Executive Chairman and it was left to his choice to continue or not, as Non-Executive Director of Tata Sons.

2.8 As a follow up, certain things happened and by separate Resolutions passed at the meetings of the shareholders of Tata Industries Limited, Tata Consultancy Services Limited and Tata Teleservices Limited, CPM was removed from Directorship of those companies. CPM then resigned from the Directorship of a few other operating companies such as the Indian Hotels Company Limited, Tata Steel Limited, Tata Motors Limited, Tata Chemicals Limited and Tata Power Company Limited, after coming to know of the impending resolutions to remove him from Directorship.

2.9 Thereafter, 2 companies by name, Cyrus Investments Private Limited and Sterling Investment Corporation Private Limited, belonging to the SP Group, in which CPM holds a controlling interest, filed a company petition in C.P No.82 of 2016 before the National Company Law Tribunal under Sections 241 and 242 read with 244 of the Companies Act, 2013, on the grounds of unfair prejudice, oppression and mismanagement.

2.10 But these two companies, hereinafter referred to as 'the complainant companies', together had only around 2% of the total issued share capital of Tata Sons. This is far below the *de-minimus* qualification prescribed under Section 244(1)(a) to invoke sections 241 and 242. Therefore, the complainant companies filed a miscellaneous application under the proviso to Subsection (1) of Section 244 seeking waiver of the requirement of Section 244(1)(a), which requires at least one hundred members of the company having a share capital or one tenth of the total number of fixed members or any member or members holding not less than one-tenth of the issued share capital of the company alone to be entitled to be the applicant/applicants.

2.11 Along with the application for waiver of the requirement of Section 244(1)(a), the complainant companies also moved an application for stay of an Extraordinary General Meeting ("EGM" for short) of Tata Sons, in which a proposal for removing CPM as a Director of Tata Sons had been moved. The NCLT refused stay, as a consequence of which the EGM proceeded as scheduled and CPM was removed from the Directorship of Tata Sons, by a Resolution dated 16.02.2017.

2.12 Subsequently, by an Order dated 06.03.2017, NCLT held the main company petition to be not maintainable at the instance of persons holding just around 2% of the issued share

capital. This was followed by another order dated 17.4.2017, by which NCLT dismissed the application for waiver.

2.13 The complainant companies filed appeals before NCLAT against both the Orders dated 06.03.2017 and 17.04.2017. These appeals were allowed on 21.09.2017, granting waiver of the requirement of Section 244(1)(a) and remanding the matter back to NCLT for disposal on merits. Tata Group did not challenge this order.

2.14 Thereafter, NCLT heard the company petition on merits and dismissed the same by an Order dated 09.07.2018. 2.15 Challenging the order of the NCLT, the two complainant companies filed one appeal. CPM filed another appeal. Both these appeals were allowed by the Appellate Tribunal by a final Order dated 18.12.2019 granting the following reliefs:

(i) The proceedings of the sixth meeting of the Board of Directors of 'Tata Sons Limited' held on Monday, 24th October, 2016 so far as it relates to removal and other actions taken against Mr. Cyrus Pallonji Mistry (11th Respondent) is declared illegal and is set aside. In the result, Mr. Cyrus Pallonji Mistry (11th Respondent) is restored to his original position as Executive Chairman of 'Tata Sons Limited' and consequently as Director of the 'Tata Companies' for rest of the tenure.

As a sequel thereto, the person who has been appointed as 'Executive Chairman' in place of Mr. Cyrus Pallonji Mistry (11th Respondent), his consequential appointment is declared illegal.

(ii) Mr. Ratan N. Tata (2nd Respondent) and the nominee of the 'Tata Trusts' shall desist from taking any decision in advance which requires majority decision of the Board of Directors or in the Annual General Meeting.

(iii) In view of 'prejudicial' and 'oppressive' decision taken during last few years, the Company, its Board of Directors and shareholders which has not exercised its power under Article 75 since inception, will not exercise its power under Article 75 against Appellants and other minority member. Such power can be exercised only in exceptional circumstances and in the interest of the company, but before exercising such power, reasons should be recorded in writing and intimated to the concerned shareholders whose right will be affected.

(iv) The decision of the Registrar of Companies changing the Company ('Tata Sons Limited') from 'Public Company' to 'Private Company' is declared illegal and set aside. The Company ('Tata Sons Limited') shall be recorded as 'Public Company'. The 'Registrar of Companies' will make correction in its record showing the Company ('Tata Sons Limited') as 'Public Company'." 2.16 After NCLAT disposed of the appeals by its order dated 18122019, the Registrar of Companies moved 2 interlocutory applications seeking the deletion of certain remarks made by NCLAT against them. These applications were dismissed by NCLAT by

order dated 06012020. Therefore, as against the final Order of NCLAT dated 18122019, (i) Tata Sons Private Limited (ii) RNT (iii) the Trustees of the two Tata Trusts and (iv) three operating companies of Tata Group have come up with 2 Civil Appeals each (totalling to 12 appeals) and the complainant companies have come up with one Civil Appeal. In addition, Tata Sons have also come up with 2 more appeals against the order dated 06012020 passed by NCLAT on the applications of the Registrar of Companies.

3. Case set up by the complainants in their petition under sections 241 and 242, Companies Act, 2013 and Reliefs sought

3.1 In the company petition as it was originally filed by S.P. Group in December, 2016 before the NCLT, the complainant companies claimed that the affairs of Tata Sons, are carried out as though it was a proprietary concern of RNT and that the oppressive conduct of the respondents was such that it would be just and equitable to wind up Tata Sons, but such winding up would unfairly prejudice the interest of the petitioners and that therefore the Tribunal should pass such orders so as to bring to an end, the acts of oppression and mismanagement.

3.2 The acts of oppression and mismanagement complained against Tata Sons revolved around (i) alleged abuse of the Articles of Association, particularly Articles 121, 121A, 86, 104B and 118, to enable the trusts and its nominee Directors to exercise control over the Board of Directors; (ii) alleged illegal removal of CPM as Executive Chairman without any notice and an all out attempt to remove him from the Directorship of all the operating companies of the Tata group; (iii) alleged dubious transactions in relation to Tata Teleservices Limited, alongwith one Mr. C. Sivasankaran; (iv) RNT allegedly treating Tata Sons as a proprietorship concern with all others acting as puppets, resulting in the Board of Directors failing the test of fairness and probity (v) acquisition of Corus Group PLC of UK at an inflated price and then jeopardising the talks for its merger with Thyssen Krupp (vi) Nano car project becoming a disaster with losses accumulating year after year and the conflict of interest that RNT had in the supply of Nano gliders to a company where he had stakes; (vii) providing corporate guarantee to IL & FS Trust Company for the loan sanctioned by Standard Chartered Bank to Sterling (viii) making Kalimati Investments Ltd, a subsidiary of Tata Steel to provide an inter corporate bridge loan to Sterling; (ix) the dealings with NTT DoCoMo and Sterling resulting in an arbitration award for a staggering amount; (x) leaking information to Siva of Sterling that resulted in Siva issuing legal notices to Tata Teleservices and Tata Sons (xi) RNT making a personal gain for himself through the sale of a flat owned by a Tata group company to Mehli Mistry; (xii) companies controlled by Mehli Mistry receiving favours due to the personal relationship that RNT had with him; and (xiii) fraudulent transactions in the deal with Air Asia which led to financing of terrorism.

3.3 On the foundation of the above, the complainant companies contended before NCLT: (i) that the directors of Tata Sons are not carrying out their fiduciary responsibilities for and on behalf of the shareholders, but have become mere puppets controlled by RNT and the

Trustees of the two Trusts; (ii) that the powers contained in the Articles of Association are being exercised in a *malafide* manner prejudicial to the interest of the petitioners and to public interest; (iii) that various operating decisions are taken either for emotional reasons or for pampering the ego of RNT; (iv) that attempts are made to shield persons responsible for fraudulent transactions at Air Asia; (v) that attempts are made to ensure that no legal action is initiated against Siva who owes Rs. 694 crores; (vi) that Ratan Tata enabled his associates to unjustly enrich themselves at the cost of Tata Sons; and (vii) that the present directors of Tata Sons are not promoting the interests of shareholders of Tata Sons and the interests of the shareholders of various operating companies of the Tata group.

3.4 In the light of the above pleadings and contentions, the petitioners before the NCLT sought a set of about 21 reliefs, whose abridged version is as follows:

"(A) Supersede the existing Board of Directors of Respondent No. 1 and appoint an administrator;

(B) In the alternative to prayer (A) above, appoint a retired Supreme Court Judge as the non-executive Chairman of the Board of Directors of Respondent No. 1 and appoint such number of new independent directors;

(C) restrain the socalled "Interim Chairman" i.e Respondent No. 2 from attending any meeting of the Board of Directors;

(D) restrain Respondent No. 14 from interfering in the affairs of Respondent No. 1;

(E) direct Respondent No. 1 not to issue any securities which results in dilution of the present paidup equity capital;

(F) direct the Respondents not to remove Respondent No. 11 as a director from the Board of Respondent No. 1;

(G) restrain the Respondents from making any changes to the Articles of Association of Respondent No. 1;

(H) order an investigation into the role of the Trustees of the Tata Trusts in the operations of Respondent No. 1 and/or Tata Group companies and prohibit the Trustees from interfering in the affairs of Respondent No. 1 and/or Tata Group companies;

(I) appoint an independent auditor to conduct a forensic audit into transactions and dealings of Respondent No. 1 with particular regard to all transactions with C.Sivasankaran and his business entities and all transactions involving Mr. Mehli Mistry and his associated entities and such findings of the audit and investigation should be referred to the Serious Fraud Investigation Office;

(J) Appoint an inspector (under applicable law) to investigate into the breach of the SEBI (Prohibition of Insider Trading) Regulations, 2015 and/or refer the findings of such investigation to the Serious Fraud Investigation Office of the Ministry of Corporate Affairs, Government of India.

(K) direct Respondent No.2 to pay Respondent No. 1 the amount of unjust enrichment that has accrued to Respondent No. 2 on account of surrender of the subtenancy of the Bakhtawar flat;

(L) appoint a forensic auditor to reinvestigate the transactions executed by AirAsia with entities in India and Singapore and such findings of the audit should be referred by the Hon'ble Tribunal to the Serious Fraud Investigation Office of the Ministry of Corporate Affairs, Government of India;

(M) strike of Articles numbered 86, 104(B), 118, 121 and 121A in their entirety and in so far as Article 124 of the Articles of Association of Respondent No. 1 is concerned, the following portion of the said Article, which is offending and/or repugnant, should be deleted: "... Any committee empowered to decide on matters which otherwise the Board is authorised to decide shall have as its member at least one director appointment pursuant to Article 104B. The Provisions relating to quorum and the manner in which matters will be decided contained in Articles 115 and 121 respectively shall apply mutatis mutandis to the proceedings of the committee. "from the Articles of Association of Respondent No. 1; and substitute these articles with such articles as the nature and circumstances of this case may require;

(N) direct the Respondents (excluding Respondent Nos. 4, 10 &11) to bring back into Respondent No. 1, the funds used by Respondent No. 1 for acquiring shares of Tata Motors;

(O) restrain Respondent No. 1 from initiating any new line of business or acquiring any new business;

(P) restrain the trustees of the Trusts from interfering in the affairs of Respondent No. 1 and in the various companies;

(Q) restrain the existing Selection Committee from acting any further.

(R) direct that no candidate selected by the Selection Committee constituted pursuant to Article 118 of the Articles of Association of Respondent No. 1 to be appointed without leave of this Hon'ble Tribunal;

(S) direct Respondent No. 1 not to demand and/or procure any unpublished price sensitive information from any listed operating companies within the Tata Group;

(T) grant interim and adinterim reliefs in terms of Prayers (A) to (S) above;

and (U) pass such further orders that this Hon'ble Tribunal may, deem necessary for bringing an end to the acts of oppression and mismanagement in the running of Respondent No. 1."

4. <u>Amendment of pleadings, addition and deletion of reliefs</u>

4.1 The contents of Chapter 3 above, are the pleadings made and the reliefs sought in the company petition, as it was originally filed on 20.12.2016. But the pleadings and the prayers underwent certain changes in the course of the proceedings, partly due to subsequent developments and partly due to change of strategy/better counsel.

4.2 What is important to note here is that some of the changes to the pleadings and the reliefs sought, were by way of proper applications for amendment and some others were just by way of additional affidavits. We shall advert to them in this part.

4.3 The company petition filed on 20.12.2016 was taken up on 22.12.2016 and the NCLT passed an order to the following effect: "It has also been further agreed by all the parties more specially by the petitioner counsel, or R11 counsel and the counsel on behalf of the answering respondents that they will not file any interim application or initiate any action or proceedings over this subject matter pending disposal of this company petition."

4.4 Soon, the matter got precipitated. Claiming that CPM sent four boxfiles containing several documents relating to Tata Education Trust, to the Deputy Commissioner of Income Tax with a view to create trouble, a special notice was issued for convening the EGM of Tata Sons on 06.02.2017 for considering the proposal for the removal of CPM as a Director of Tata Sons.

4.5 Therefore, the complainant companies moved a contempt application. The said application was disposed of by NCLT by an order dated 18.01.2017, permitting the complainant companies and CPM to file an additional affidavit limiting to the proposal for the removal of Cyrus Pallonji Mistry from the Board. 4.6 Accordingly, an additional affidavit was filed on 21.01.2017. However, the NCLT, by an order dated 31.01.2017 rejected the prayer of S.P. Group for stay of EGM scheduled to be held on 06.02.2017.

4.7 S.P. Group filed an appeal against the order refusing the stay of EGM. The appeal was disposed of on 03.02.2017, merely permitting the S.P. Group to file a petition for amendment, in the event of CPM being removed in the EGM. In the EGM held on 06.02.2017, CPM was removed.

4.8 Therefore, the complainant companies filed an amendment application dated 10.02.2017 seeking addition of two more prayers namely: (i) to direct the respondents to reinstate the representative of the complainant companies on the Board of Tata Sons; and (ii) to direct the amendment of Articles of Association of Tata Sons to provide for proportional representation of shareholders on the Board of Directors of Tata Sons.

4.9 But the petition for contempt, the petition for interim stay of EGM and the application for amendment to include additional prayers, all turned out to be exercises in futility, with the NCLT passing two orders, one on 06.03.2017 and another on 17.04.2017. By the first order dated 06.03.2017, NCLT held the company petition to be not maintainable, on the ground that

the two complainant companies did not hold at least 10% of the issued share capital of Tata Sons. By the second order dated 17.04.2017, NCLT rejected the application for grant of waiver filed under the proviso to Subsection (1) of Section 244.

4.10 But the aforesaid orders of NCLT dated 06.03.2017 and 17.04.2017 were reversed by NCLAT by an order dated 21.09.2017 and the matter was remanded back to NCLT.

4.11 Thereafter, the complainant companies filed one additional affidavit, one application for amendment, one application for stay and one memo giving up some of the reliefs already sought. The facts relating to these, can be compressed into a tabular column as follows:

Sl.No.	**What was filed**	**Reliefs sought**
1.	Additional affidavit dated 31.10.2017	This additional affidavit sought to challenge the conversion of Tata Sons from being a Public Limited Company into a Private Limited Company.
2.	Application for amendment dated 31.10.2017	By this application, the complainants sought the following prayers: (M1): Set aside the resolution passed by the shareholders of respondent No.1 on September 21, 2017 insofar as it seeks to amend the Articles of Associations and Memorandum of Association of Respondent No.1 for conversion of Respondent No.1 into a private company. (M2): Strike off/Delete Article

		75 as the same is a tool in the hands of the majority shareholders to oppress the minority; and; (M3): Pending the final hearing disposal of the Company Petition, the effect and operation of the resolution dated September 21, 2017 be stayed. (F1): Direct Respondent No.1 and/or Respondent No. 2 to 10 and 12 to 22 to reinstate a representative of the Petitioners on the Board of Respondent No.1 (G1): Direct that the Articles of Association of Respondent No.1 be amended to provide for proportionate representation of shareholders on the Board of Directors of Respondent No.1
3.	Application for stay dated 31.10.2017	Through this application, the complainants sought Stay of conversion of Tata Sons into a Private Limited Company.

4.	Memo dated 12.01.2018	By this memo, certain reliefs originally sought, were given up, certain reliefs originally prayed for, were not pressed and one particular relief was sought to be restricted. The prayer in the Memo was as follows:¬ a. Prayer M, which sought the striking of Articles 86, 104(B), 118, 121 and 121A, and striking of a portion of Article 124, is restricted as under: i. The necessity of an affirmative vote of the majority of directors nominated by the Trusts, which are majority of shareholders, be deleted; ii. The Petitioners be entitled to proportionate representation on Board of Directors of Respondent No.1; iii. The Petitioners be entitled to representation on

		all committees formed by the Board of Directors of Respondent No.1; and iv. The Articles of Association be amended accordingly. b. Prayers A, B and C were not pressed. c. Prayers F, Q and R, being infructuous were not pressed.

5. <u>Response of Tata Sons to the allegations made in the Company Petition</u>

5.1 Tata Sons filed a reply to the company petition contending *inter-alia* : (i) that CPM, who was removed from the post of Executive Chairman, after having lost the confidence of 7 out of 9 Directors, has sought to use the complainant companies to besmirch the reputation of Tata Group; (ii) that even the decisions to which CPM was a party have been questioned in the petition; (iii) that Tata Group founded in 1868 is a global enterprise, headquartered in India, comprising over a hundred operating companies, having presence in more than 100 countries across six continents, collectively employing over 6,60,000 people; (iv) that the revenue of Tata Group in 201516, was $103.51 billion; (v) that there are 29 publicly listed companies in the Tata Group with a combined market capitalisation of about $116.41 billion; (vi) that 65.3% of the issued ordinary share capital of Tata Sons is held by philanthropic trusts which support education, health, livelihood generation and art and culture; (vii) that it was at the instance of CPM that RNT was designated as Chairman Emeritus and he was requested to attend Board Meetings as a special and permanent invitee and continue to guide the Board; (viii) that Articles 104B and 121 were introduced through a new version of Articles of

Association at the Annual General Meeting of Tata Sons held on 13.09.2000 and Article 121 was subsequently amended by Resolution dated 09.04.2014; (ix) that Shri Pallonji Shapoorji Mistry, who represented the complainant companies, was present at the General meeting held on 13.09.2000; (x) that CPM himself was a party to the Resolution passed by the shareholders on 09.04.2014, introducing Articles 121A and 121B; (xi) that CPM's leadership gave rise to certain issues such as insufficient detail and discipline on capital allocation decisions, slow execution on identified problems, lack of specificity and follow through in strategic plan and business plan, failure to take meaningful steps to enter new growth businesses, weak top management team and reluctance to embrace the Articles of Association that spelt out the governance structure of the company and the rights of Tata Trusts; (xii) that there was a growing trust deficit between the Board of Directors of Tata Sons and CPM due to several reasons, such as the conflict of interest in the matter of award of contracts to S.P. Group of companies and his systematic and planned reduction of the representation of Tata Sons Directors on the Boards of other major Tata Companies; (xiii) that even when the Directors of Tata Sons resolved on 24.10.2016 to replace CPM as Executive Chairman, the Board agreed to his continuance as a Director of Tata Sons; (xiv) that however CPM addressed a vitriolic mail on 25.10.2016 to the Directors making false allegations; (xv) that though the mail was marked confidential, it was simultaneously leaked to the press; (xvi) that CPM also breached his fiduciary and contractual duties by disclosing confidential information and documents pertaining to Tata Sons to third parties; (xvii) that CPM made representations to the shareholders of all operating companies, with unsubstantiated and false allegations, thereby attempting to make the operating companies vulnerable to make confidential data available for public inspection; (xviii) that the shareholders of Tata Industries Limited, Tata Consultancy Services and Tata Teleservices Limited passed Resolutions respectively on 12.12.2016, 13.12.2016 and 14.12.2016 to remove CPM from Directorship; (xix) that, therefore, CPM resigned from the Directorship of the other companies also on 19.12.2016, when he faced the prospect of being removed in the impending meetings; (xx) that the actions and conduct of CPM after 24.10.2016 compelled Tata Sons to issue a special notice and requisition for his removal from the Directorship of Tata Sons; (xxi) that the company petition was not about espousing the cause of corporate governance or seeking remedies for oppression and mismanagement of Tata Sons; (xxii) that prior to his removal as Executive Chairman, CPM never raised any concerns regarding any oppression or mismanagement; (xxiii) that many of the acts of oppression complained of by the complainant companies, have happened long before the date of filing of the company petition, showing thereby that the company petition was hopelessly barred by delay and laches.

5.2 On the allegations of oppression and mismanagement, the response of Tata Sons was as follows: (i) that the complainant companies have cherry picked certain business decisions to launch a vitriolic attack on the Tata Trusts; (ii) that while the complainant companies have talked about bad business deals, such as Corus acquisition and Nano Project, they have deliberately omitted to talk about Tetley acquisition by Tata Global Beverages Limited, the immensely successful Jaguar Land Rover acquisition by Tata Motors and the phenomenal success of Tata Consultancy Services; (iii) that Corus acquisition, the Nano Project, contracts

awarded to the business concerns of Mr. Mehli Mistry and the investment by Mr.C. Sivasankaran have surfaced only after the replacement of Mr. Cyrus Mistry as the Executive Chairman; (iv) that CPM has been the Director of Tata Sons since the year 2006 and was also the Executive Chairman from December, 2012 to October, 2016 and was fully aware of how the decisions relating to these projects were taken when they were taken; (v) that courts cannot be called upon to sit in judgment over the commercial decisions of the Board of Directors of companies; and (vi) that even commercial mis judgments of the Board of Directors cannot be branded as instances of oppression and mismanagement.

5.3 On specific acts of oppression and mismanagement, raised in the company petition, such as (i) over priced and bleeding acquisition of Corus PLC of UK; (ii) doomed Nano car project; (iii) loan advanced by Kalimati Investments to Siva; (iv) sale of the residential flat to Mehli Mistry; (v) unjust enrichment of Mehli Mistry and the companies controlled by him, due to the personal equation of RNT with him; (vi) aviation industry misadventures; and (vii) a huge loss due to purchase of shares of Tata Motors, the reply filed by Tata Sons contained an elaborate and graphic rebuttal. We shall take note of them later, while dealing with the question whether or not the allegations constitute the ingredients of sections 241 and 242 of the Act.

6. The approach of NCLT

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7. The Approach of NCLAT

7.1 While NCLT dealt with every one of the allegations contained in the main company petition and recorded its findings, NCLAT, curiously, focused attention only on (i) the removal of CPM (ii) the affirmative voting rights of the Directors nominated by the 2 Trusts in the decision making process and (iii) the amended certificate of incorporation issued by the RoC, deleting the word “Public” and making it a private company once again.

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8. <u>Important difference between the approach of NCLT and the approach of NCLAT</u>

8.1 As pointed out at the beginning of chapter 7, NCLT dealt with every one of the allegations of oppression and mismanagement and recorded reasoned findings. But NCLAT, despite being a final court of facts, did not deal with the allegations one by one nor did the NCLAT render any opinion on the correctness or otherwise of the findings recorded by NCLT. Instead, the NCLAT summarised in one paragraph, namely paragraph 183, its conclusion on some of the allegations, without any kind of reasoning. This Paragraph 183 reads as follows:

"The facts, as noticed above, including the affirmative voting power of the nominated Directors of the 'Tata Trusts' over majority decision of the Board; actions taken by Mr. Ratan N. Tata (2nd Respondent), Mr. Nitin Nohria (7th Respondent) and Mr. N.A.Soonawala (14th Respondent) and others as discussed above; the fact that the Company ('Tata Sons Limited') has suffered loss because of 'prejudicial' decisions taken by Board of Directors; the fact that a number of 'Tata Companies' have incurred loss; in spite of decision making power vested with the Board of Directors with affirmative power of nominated Directors of the 'Tata Trusts'; the action in making change from 'Public Company' to 'Private Company'; the manner in which Mr. Cyrus Pallonji Mistry (11th Respondent) was suddenly and hastily removed without any reason and in absence of any discussion in the meeting shown in the Board of Directors held on 24th October, 2016 and his subsequent removal as Director(s) of different 'Tata Companies', coupled with global effect of such removal, as accepted by the Company in its 'Press Statement' form a consecutive chain of events with cumulative effect justifying us to hold that the Appellants have made out a clear case of 'prejudicial' and 'oppressive' action by contesting Respondents, including Mr. Ratan N. Tata (2nd Respondent), Mr. Nitin Nohria (7th Respondent) and Mr. N.A.Soonawala (14th Respondent) and other, the nominee Directors.

8.2 The allegations relating to (i) over priced and bleeding Corus acquisition (ii) doomed Nano car project (iii) undue favours to Siva and Sterling (iv) loan by Kalimati to Siva (v) sale of flat to Mehli Mistry (vi) the unjust enrichment of the companies controlled by Mehli Mistry (vii) the Aviation industry misadventures (viii) losses due to purchase of the shares of Tata Motors etc., were not individually dealt with by NCLAT, though NCLT had addressed each one of these issues and recorded findings in favour of Tata Sons. Therefore, there is no escape from the conclusion that NCLAT did not expressly overturn the findings of facts recorded by NCLT, on these allegations. We are constrained to take note of this, even at the outset, in view of a contention raised by Shri Shyam Divan, learned Senior Counsel for the SP group, that in an appeal under Section 423 of the Companies Act, 2013, this court will not normally interfere with a finding of fact reached by NCLAT, unless it is found to be wholly perverse.

9. Contentions on behalf of Tata Sons, group companies and Trustees

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10. Contentions on behalf of S.P. Group:

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11 Contentions on behalf of the Tata Trusts

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12. Contentions of Tata Consultancy Services (TCS)

XXXXXXXX

13. Contentions of others

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14. <u>Questions of law arising for consideration</u>

14.1 Though the learned counsel for the parties have raised innumerable contentions touching upon every aspect, micro or macro, and which we have faithfully recorded in paragraphs 9 to 13 above, the jurisdiction of this Court under Section 423 of the Companies Act, 2013, is primarily to answer questions of law arising out of the proceedings before the Tribunal and Appellate Tribunal.

14.2 Therefore, from the rival contentions, the questions of law that arise are formulated as follows:

(i) Whether the formation of opinion by the Appellate Tribunal that the company's affairs have been or are being conducted in a manner prejudicial and oppressive to some members and that the facts otherwise justify the winding up of the company on just and equitable ground, is in tune with the well settled principles and parameters, especially in the light of the fact that the findings of NCLT on facts were not individually and specifically overturned by the Appellate Tribunal ?

(ii) Whether the reliefs granted and the directions issued by the Appellate Tribunal, including the reinstatement of CPM into the Board of Tata Sons and other Tata companies, are in consonance with the pleadings made, the reliefs sought and the powers available under Sub-section (2) of Section 242 ?

(iii) Whether the Appellate Tribunal could have, in law, muted the power of the Company under Article 75 of the Articles of Association, to demand any member to transfer his ordinary shares, by simply injuncting the company from exercising such a right without setting aside the Article?

(iv) Whether the characterisation by the Tribunal, of the affirmative voting rights available under Article 121 to the Directors nominated by the Trusts in terms of Article 104B, as oppressive and prejudicial, is justified especially after the challenge to these Articles have been given up expressly and whether the Tribunal could have granted a direction to RNT and the Nominee Directors virtually nullifying the effect of these Articles ?

(iv) whether the reconversion of Tata Sons from a public company into a private company, required the necessary approval under section 14 of the Companies Act, 2013 or at least an action under section 43A(4) of the Companies Act, 1956 during the period from 2000 (when Act 53 of 2000 came into force) to 2013 (when the 2013 Act was enacted) as held by NCLAT?

15. Legislative History of Oppression, Mismanagement and Unfair Prejudice

15.1 Before we take up the questions of law formulated above for consideration, we think it would be useful to look at the legislative history of oppression, mismanagement and prejudice/ unfair prejudice, both in England and India, as colonial vintage continues to haunt us (fortunately or unfortunately), both in legislative drafting and in judicial decision making even till date. In England

15.2 The history of legislative action to regulate incorporated companies, in England, is just 176 years old. It begins with the Joint Stock Companies Act, 1844. Until then, the government created corporations under a Royal Charter or an Act of Parliament with the grant of a monopoly over a specified territory. The best known example is the British East India Company, to which Queen Elizabeth I granted the exclusive right to trade with all countries to the east of the Cape of Good Hope. During this period, Corporations essentially used to act on the government's behalf, bringing in revenue from their exploits abroad.

15.3 A chartered company (similar to East India Company), known as the South Sea Company, was established in 1711 to trade in the Spanish South American colonies. The South Sea Company's monopoly rights were supposedly backed by the Treaty of Utrecht, signed in 1713 as a settlement following the War of Spanish Succession. Investors in the UK were promised high returns of unimaginable proportions, which led to the shares of the company being traded by avaricious investors at high premium. By 1717, the South Sea Company became so wealthy despite having done no real business that it assumed the public debt of the UK government. This was the first speculative bubble that the country (or perhaps the world) saw, but by the end of 1720, the bubble had "burst", leading to bankruptcies and the passage of The Bubble Act, 1720.

15.4 The UK Bubble Act, 1720 prohibited the establishment of companies without a Royal Charter and it remained in force until its repeal in 1825. By 1825, Industrial Revolution had gathered pace, necessitating a legal change. The Bubble Companies Act 1825 lifted the restrictions, but it did not resolve the problem fully.

15.5 Therefore in 1843, the Parliamentary Committee on Joint Stock Companies, chaired by William Gladstone made a report, which led to the enactment of the Joint Stock Companies Act 1844. This Act made it possible for ordinary people to incorporate companies through a simple registration procedure. However, it did not permit limited liability.

15.6 Then came the Limited Liability Act, 1855, which allowed investors to limit their liability in the event of business failure, to the amount they invested in the company. These two features a simple registration procedure and limited liability were subsequently codified in the first modern company law enactment, namely the Joint Stock Companies Act 1856. The Joint Stock companies Act, 1856 made it possible for any 7 individuals, subscribing to shares individually, to form a limited liability company. This was subsequently consolidated with a number of other statutes in the Companies Act 1862, which was described by Francis Palmer as the Magna Carta of Cooperative enterprises.

15.7 The Companies Act, 1862 consolidated the laws relating to the incorporation, regulation and winding up of trading companies and other associations. Though this Act did not provide for any remedies to the minority shareholders in respect of oppression and mismanagement, Section 79 empowered the Court to wind up a company whenever the Court was of the opinion that it is just and equitable to wind up the company. This Act also contained a provision conferring a limited right upon a dissentient member, whenever a sale or transfer of the business or property of the company took place in the course of winding up proceedings.

15.8 However, when fraudulent practices in relation to the formation and management of companies came to the fore, an investigation was ordered by a Committee chaired by Lord Davey. The Committee submitted a report along with a draft Bill in June, 1895. This Bill became the Companies Act, 1900. This Act also did not contain any provision relating to oppression and mismanagement. So was the case with the Companies (Consolidation) Act, 1908. The Act of 1908 was examined by a committee presided over by Lord Wrenbury in 1918 and again by a committee headed by Greene, K.G. in 1926, which led to the Companies Act, 1929.

15.9 During the second world war, a Company Law Reforms Committee chaired by Lord Cohen was appointed (in 1943) by the President of the Board of Trade to consider and report what major amendments are needed to the 1929 Act, particularly *"to review the requirements prescribed in regard to the formation and affairs of companies and the safeguards afforded for investors and for the public interest*". This Committee's report dealt specifically with 2 problems, namely (i) the hardship caused to the legal heirs of a deceased shareholder of a private company in the matter of disposal of the shares, due to the restriction on the transferability of shares and (ii) the abuse of office by the Directors in siphoning off huge profits in the form of remuneration, to the detriment of the small shareholders. After analyzing these 2 issues in paragraphs 58 and 59 as illustrative cases, the Cohen Committee, recommended that "*a step in the right direction would be to enlarge the power of the Court to make a winding up order by providing that the power shall be exercisable notwithstanding the existence of an alternative remedy*".

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15.10 Ultimately, in para 153 of the report, a recommendation was made to amend the provision relating to winding up, by adding the following:

There be a new section under which, on a shareholder's petition, the Court, if satisfied that a minority of the shareholders is being oppressed and that a winding up order would not do justice to the minority, should be empowered, instead of making a winding up order, to make such other order, including an order for the purchase by the majority of the shares of the minority at a price to be fixed by the Court, as to the Court may seem just

15.11 Lord Cohen committee report led to the enactment of the Companies Act, 1948, in which a provision was incorporated in section 210. The heading given to the Section was, "Alternative Remedy to Winding up in Cases of Oppression".

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15.12 But the word "oppressive" appearing in section 210 of the 1948 Act, was construed by the House of Lords in ***Scottish Cooperative Wholesale Society vs. Meyer,*** 1959 A.C.324 to mean ***"burdensome, harsh and wrongful"***. The expression "wrongful" gave rise to some uncertainty as to whether it required actual illegality or invasion of legal rights. Moreover, the provision invited 2 criticisms namely (i) that the requirement to establish grounds which justified winding up under the just and equitable clause was itself harsh and (ii) that section 210 would not apply to an isolated act, but applied only to a course of conduct.

15.13 Therefore, the Jenkins Committee of 1962 recommended use of the term "unfairly prejudicial". Parliament adopted it in Section 75 of the Companies Act, 1980. Later, this section 75 of the 1980 Act became, with an amendment, Section 459 of the Companies Act, 1985. Sections 459 to 461 of the Companies Act, 1985 were included in Part XVII, under the caption "Protection of Company's Members against Unfair Prejudice". Sections 459 to 461 read as follows:

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15.14 The Companies Act, 1985 was repealed by the Companies Act, 2006, which had the dubious distinction of being the longest Act in British parliamentary history, with 1300 sections and 16 schedules. (until it was overtaken by the Corporation Tax Act, 2009). Part 30 of the Act contains 3 provisions in sections 994 to 996 (apart from others), grouped under the heading "Protection of Members against Unfair Prejudice". Paragraph 1265 of the Explanatory Notes to the 2006 Act, confirms that Sections 994-998 restate sections 459, 460 and 461 of the 1985 Act.

Legislative history in India

15.16 In India, the earliest legislation made for the 'Regulation of Registered Joint Stock Companies' was Act No. XLIII of 1850. This Act provided for the registration of every un-

incorporated company of partners, associated under a deed containing a provision that the shares in the stock or business of the said company, are transferable without the consent of all the partners. It will be fascinating for those interested in history, to know that under this 1850 Act, the Supreme Courts of Judicature at Calcutta, Madras and Bombay were conferred not only with the power of registration of such companies but also with a power to enforce the performance by the directors of any of their duties under the Act or the deed of partnership. These courts also had a consequential power to punish a person for contempt, if there was any disobedience of the order of the court. The concepts such as minority, majority, oppression, mismanagement etc., were alien to this Act of 1850.

15.17 Then came Act No.XIX of 1857 which provided for the incorporation and regulation of joint stock companies and other associations either with or without limited liability of the members thereof. The primary object of the Act was to enable the members of the joint stock companies and other associations to limit their liability for the debts and engagements relating to those companies and associations. It was under this Act that for the first time the prescription that 7 or more persons associated for any lawful purpose may form themselves into an incorporated company with or without limited liability by subscribing their names to a Memorandum of Association, was introduced. By this very same Act the prohibition for 20 or more persons to carry on any partnership in trade or business having gain as its object, unless they are registered as a company, was also introduced. But even in this Act the concepts such as oppression and mismanagement etc., were not dealt with (perhaps due to the fact that East India Company alone was granted such a privilege).

15.18 Thereafter, a full-fledged enactment known as The Indian Companies' Act, 1866 was passed with a view to consolidate and amend the laws relating to the incorporation, regulation and winding up of trading companies and other associations. Even this Act, did not provide for any remedy in the case of oppression and mismanagement, though provisions were made for winding up including voluntary winding up.

15.19 The above Act No. X of 1866 was repealed by The Indian Companies Act No. VI of 1882. This Act also did not contain provisions for an individual or group of shareholders/members to seek redressal against oppression, mismanagement or any unfair prejudicial treatment.

15.20 Then came The Indian Companies Act, 1913 (Act No.VII of 1913) which repealed the 1882 Act and the amendments made thereof. Interestingly, this 1913 Act also repealed one particular provision in the Indian Arbitration Act, 1899. Though in the original enactment of 1913, there was no provision relating to oppression and mismanagement, the Amendment Act 52 of 1951 inserted Section 153C to The Indian Companies Act, 1913. This Section 153C reads as follows : "***153C. Power of court to act when company acts in a prejudicial manner or oppresses any part of its members.***- XXXXXX

15.21 After the country attained independence, a Company Law Committee was appointed by the Government of India for the revision of the Companies Act with particular reference to Indian trade and industry. The Committee submitted its report in March 1952. After circulating the Report to all State Governments, Chambers of Commerce, Trade Associations and other bodies and after examining the inputs received, the Companies Act, 1956 (Act no.1 of 1956) was passed. This Act included a full Chapter in Chapter VI of Part VI, containing elaborate provisions for the prevention of oppression and mismanagement. This Chapter was divided into two parts, with Part A dealing with the powers of the Court/Tribunal and Part B dealing with the powers of the Central Government. Sections 397, 398 and 402 of the Act are of significance and, hence, they are extracted as follows:

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15.22 After the economy of the country opened up and the national and international economic environment changed, the Government decided to replace the 1956 Act with a new one. Accordingly, the Companies Bill, 2009 was introduced in the Lok Sabha. But this bill was withdrawn and the Companies Bill, 2011 was introduced. This eventually became the Companies Act 2013. Among the many changes brought about by this Companies Act 2013, those relating to protection of minority shareholders is what is relevant for our purpose. In fact, paragraph 5(ix) of the Statement of Objects and Reasons for the Companies Act, 2013 deals with the issue of protection of minority shareholders. It reads as follows:

"5. (ix) Protection for Minority Shareholders:

(a) Exit option to shareholders in case of dissent to change in object for which public issue was made.

(b) Specific disclosure regarding effect of merger on creditors, key managerial personnel, promoters and nonpromoter shareholders is being provided. The Tribunal is being empowered to provide for exit offer to dissenting shareholders in case of compromise or arrangement.

(c) The Board may have a director representing small shareholders who may be elected in such manner as may be prescribed by rules."

15.23 Chapter XVI of the 2013 Act containing Sections 241 to 246 deals exclusively with "Prevention of Oppression and Mismanagement."

Sections 241 and 242 are of relevance for our purpose and hence it is extracted as follows:

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15.24 Thus the ***English legislative history of the provisions relating to oppression, mismanagement and prejudice, show 3 milestones, namely (i) the introduction in the year 1862, of the 'just and equitable clause' for winding up and the conferment of a limited***

right on the dissentient member, whenever a transfer or sale took place in the course of winding up proceedings, (ii) the provision of an alternative remedy to winding up, in case of oppression of minority, in the year 1948 and (iii) the shift from oppression to the 'unfair prejudice' quotient in 1980/1985. The journey, in other words, was from "winding up on just and equitable cause" to "oppression" to "unfair prejudice".

15.25 But in so far as India is concerned, what was incorporated in section 210 of the English Companies Act, 1948, inspired the insertion of section 153C of the Indian Companies Act, 1913, by way of an amendment in 1951. Then came sections 397 and 398 of the 1956 Act, with certain modifications. An overhaul of these provisions resulted in Sections 241 and 242 of the 2013 Indian Act, on the model of (and not exact reproduction of) sections 459 to 461 of the English Companies Act, 1985 and sections 994 to 996 of the English Act of 2006.

15.26 The change of language and the consequential change of parameters for an inquiry relating to oppression and mismanagement from 1951 to 1956 and from 1956 to 2013 and thereafter can be best understood, if the anatomy of the statutory provisions are dissected and presented in a table :

1913 Act (After the Amendment Act 52 of 1951)	1956 Act (with the amendment made under Act 53 of 1963)	2013 Act
(1) Company's affairs **are being conducted** in a manner (a) Prejudicial to the company' interest; or (b) Oppressive to some part of the members; and (2) Winding up will unfairly **and materially prejudice the interests of the company's or any part of its members** (3) The object should be to bring to an end, the matters complained of.	(1) Company's affairs **are being conducted** in a manner (a) Prejudicial to public interest; or (b) Oppressive to any member or members; or (c) Prejudicial to the interests of the company; and (2) Winding up will unfairly prejudice **such member or members**	(1) Company's affairs **have been or are being** conducted in a manner– (a) Prejudicial to any member or members; (b) Prejudicial to public interest; or (c) Prejudicial to the interests of the company; or (d) Oppressive to any member or members. (2) Winding up will unfairly prejudice **such member or members**

15.27 From the table given above, it could be seen that the changes brought about in India in course of time, were material. These changes can be summarised as follows:

(i) While the conduct of the company's affairs in a manner that warrant interference, should be ***"present and continuing"***, under the 1913 Act and 1956 Act, as seen from the usage of the words *"are being"*, the conduct could even be ***"past or present and continuous"*** under the 2013 Act as seen from the usage of the words *"have been or are being"* (But the conduct cannot be of a distant past);

(ii) Prejudice to public interest and prejudice to the interests of any member or members were not among the parameters prescribed in the 1913 Act, but under the 1956 Act prejudice to public interest was included both under the provision relating to oppression and also under the provision relating to mismanagement. Prejudice to the interest of the company was included only in the provision relating to mismanagement. But under the 2013 Act conduct prejudicial to any member or prejudicial to public interest or prejudicial to the interest of the company are all added along with oppression;

(iii) Under the 1913 Act, the Court should be satisfied that winding up under the just and equitable clause will not only unfairly prejudice but ***"also materially prejudice"*** the interests of the company or any part of its members. But in the 1956 Act and 2013 Act, the words *"and materially"* do not follow the word *"unfairly"*. Moreover, under the 1956 Act and 2013 Act all that is required to be seen is whether the winding up will unfairly prejudice *"such member or members"* indicating thereby that the focus was on complaining/affected members.

15.29 There are a few notable features of the shift that happened in England. They are (i) from a *"conduct oppressive to some part of the members"* the focus has shifted to *"conduct unfairly prejudicial to the interests of the members generally or of some part of its members*": (ii) conduct prejudicial to public interest or prejudicial to the company's interest, does not form part of the scheme of English Law; (iii) any actual or proposed act or omission, can also be challenged under English Law on the ground that it would turn out to be prejudicial; (iv) the question of the Court forming an opinion that the facts would otherwise require an order for winding up on just and equitable ground but that the same will unfairly prejudice the complaining members, does not arise under the English Law any more.

15.30 But despite the huge shift in England, there appears to be a common thread running in all the enactments, both in India and England. In all the 3 Indian enactments, namely the 1913 Act, 1956 Act and the 2013 Act, the Court is ordained, generally to pass such orders ***"with a view to bringing to an end the matters complained of"***. This sentence is found in Section 153C(4) of the 1913 Act. It is found in Section 397(2) as well as 398(2) of the 1956 Act and it is also found in Section 242 (1) of the 2013 Act. This is also the common thread that runs through the statutory prescriptions contained in the English Acts of 1948, 1985 and 2006. Therefore, at the stage of granting relief in an application under these provisions, the final question that the Court should ask itself is as to whether the order to be passed will bring to an end the matters complained of. Having thus seen the development of law, let us now take up the questions of law one after another.

16 <u>Question No. 1</u>:

16.1 The first question of law arising for consideration is whether the formation of opinion by the Appellate Tribunal that the company's affairs have been or are being conducted in a manner prejudicial and oppressive to some members and that the facts otherwise justify the winding up of the company on just and equitable ground, is in tune with the well settled principles and parameters, especially in the light of the fact that the findings of NCLT on facts were not individually and specifically overturned by the Appellate Tribunal ?

16.2 An analysis of the provisions of Section 241(1)(a) read with clauses (a) and (b) of Sub-section (1) of Section 242 shows that a relief under these provisions can be granted only if the Tribunal is of the opinion – "(1) that the company's affairs have been or are being conducted in a manner –

(a) Prejudicial to any member or members or

(b) Prejudicial to public interest or

(c) Prejudicial to the interests of the company or

(d) Oppressive to any member or members and (2) that though the facts would justify the making of a winding up order on the basis of just and equitable clause, such a winding up would unfairly prejudice such member or members.

16.3 Keeping in mind the above statutory prescription, if we go back to the pleadings, it will be seen that the complainant companies forming part of the S.P. Group pitched their claim in their original petition on the ground:

(i) that the affairs of Tata Sons are being carried as though it was the proprietary concern of RNT; and

(ii) that though the oppressive conduct of the respondents was such that it would be just and equitable to wind up Tata Sons under Section 241, but such winding up would unfairly prejudice the interests of the complainants.

16.4 The specific allegations on which the complainant companies (of the S.P. Group) sought relief are as follows:

(i) The abuse of a few Articles of Association and the control exercised by the Tata Trust and its nominee Directors over the Board of Directors of Tata Sons;

(ii) The removal of CPM as Executive Chairman;

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16.6 None of the above findings, except the one relating to the removal of CPM was specifically and individually overturned by NCLAT. In addition NCLAT focused on the conversion of Tata Sons from a public company to a private company.

16.8 NCLAT, being an Appellate Tribunal, conferred with the power under sub-Section (4) of Section 421 to confirm, modify or set aside the order of NCLT, can be taken to be a final court of fact. An appeal from the Order of the NCLAT to this Court under Section 423 is only on a question of law. Considering the nature of the jurisdiction conferred upon NCLAT, it is clear that the findings of the NCLT, not specifically modified or set aside by NCLAT should be taken to have reached finality, unless the parties aggrieved by such non-interference by NCLAT have approached this Court, raising this as an issue. Though SP group has also filed an appeal in C.A. No. 1802 of 2020, the grievance aired therein, as seen from para 3 of the memorandum of appeal, is limited to the failure of NCLAT to grant certain reliefs. The failure of NCLAT to specifically overturn the findings of fact recorded by NCLT, is not assailed in the SP group's appeal. Therefore, we have no hesitation in holding that the allegations relating to

(i) transactions with Siva and Sterling Group of Companies;

(ii) Air Asia;

(iii) Transactions with Mehli Mistry;

(iv) the losses suffered by Tata Motors in Nano car project;

and

(v) the acquisition of Corus

reached finality.

16.9 The findings recorded by NCLAT for the grant of reliefs, revolved primarily around the removal of CPM, the affirmative voting rights, interference by nominee Directors and the conversion of Tata Sons into a private company. In other words, these are the 4 areas in which NCLAT can be taken to have undertaken a scrutiny and reversed the findings of NCLT. Therefore, for answering the first question of law, we need to focus mainly on these issues on which NCLAT expressly overruled NCLT.

16.10 Out of these 4 specific issues on which NCLAT overruled NCLT, 3 issues will also be covered in our discussion on questions of law 4 and 5.. Therefore, we shall take up in this chapter, the question (i) whether the removal of CPM could have been the basis for the allegation that the company's affairs have been or are being conducted in a manner oppressive

or prejudicial to the interests of some of the members and (ii) whether the findings recorded by NCLAT about the existence of just and equitable clause is in accordance with the well established principles of law.

Removal of CPM

16.11 CPM was first removed only from the post of Executive Chairman of Tata Sons, but not from the Directorship, by the resolution of the Board dated 24.10.2016. On the very next day namely 25.10.2016, CPM wrote a mail alleging total lack of corporate governance and failure on the part of the directors to discharge their fiduciary duties. He also called all the Trust nominee directors as postmen. Though the mail was labelled as 'confidential', a copy of the mail landed up with the media creating a "sensation". NCLT recorded a finding that CPM who owes a duty to explain this leakage of confidential mail, could not provide a satisfactory answer and that therefore, by virtue of section 106 of the Evidence Act, the leakage has to be traced to CPM. NCLAT did not overrule this finding.

16.12 The mail compelled Tata sons to issue a Press Statement on 10.11.2016. This was followed by the removal of CPM from the Directorship of Tata Industries Limited, Tata Consultancy Services Limited and Tata Teleservices Limited, all of which happened during the period from December 12 to December 14, 2016. Seeing clearly the course of destiny (which was actually set in motion by none other than himself), CPM resigned from other operating companies of Tatas such as The Indian Hotels Company Limited, Tata Steel Limited, Tata Motors Limited, Tata Chemicals Limited and Tata Power Limited, on 19.12.2016, on the eve of the Extraordinary General Meetings of those companies, convened for considering resolutions for his removal. On the very next day namely, 20.12.2016 the complainant companies, of which CPM is the pivot, filed a petition C.P.No.82 of 2016 before NCLT, Mumbai, under Sections 241 and 242 read with Section 244 of the Companies Act, 2013.

16.13 Around this time, as if by coincidence, the Principal Officer of Tata Sons received a letter dated 29.11.2016 from the Deputy Commissioner of Income Tax (Exemptions) seeking certain information under Section 133(6) of the Income Tax Act, 1961 in the case of Tata Education Trust. Tata Sons, through a reply dated 09.12.2016 furnished necessary information along with the requested documents. The Deputy Commissioner of Income Tax also called for some additional information by subsequent letters, and the information so called for, was also furnished. 16.14 Claiming that a mail dated 20.12.2016 issued by the Deputy Commissioner of Income Tax seeking further information under Section 133(6) was copymarked to him, CPM sent a reply to the Income Tax department confirming (i) that the Directors appointed by Tata Trust controlled the decision making processes by virtue of the affirmative voting rights; (ii) that RNT and Soonawala have on many occasions sought prior information and consultation; (iii) that the conduct of the Trustees posed several regulatory risks; and (iv) that the office of RNT, in his capacity as Chairman Emeritus was funded by Tata Sons, including the cost of his overseas travel by private jet. To this letter to the Deputy

Commissioner of Income Tax was enclosed certain files purportedly containing the information sought.

16.15 Upon coming to know of CPM's letter to the Deputy Commissioner of Income Tax, Tata Sons lodged a protest through a letter dated 26.12.2016. It was followed by a legal notice issued by Tata Sons to CPM on 27.12.2016 pointing out that he was guilty of breach of confidentiality and that he had passed on confidential and sensitive information contained in 4 box files, without any authority. CPM sent a legal reply dated 05.01.2017 claiming that he had a statutory obligation to cooperate with Income Tax authorities. As if to display his courage of conviction, CPM sent another letter dated 12.01.2017 to the Deputy Commissioner of Income Tax sending one more file and assuring the authorities that he would continue to check the records and submit any additional data/information as and when available.

16.16 In the light of whatever transpired as narrated above, a "Special Notice and Requisition" was moved on 03.01.2017 convening an EGM of Tata Sons for considering the removal of CPM as Director of Tata sons. It must be remembered at this stage that by the Resolution of the Board of Tata Sons dated 24.10.2016, CPM was merely removed from the post of Executive Chairman, but he continued to be a member of the Board as a Non Executive Director even after 24.10.2016. It must also be remembered that it was during his continuance as the member of the Board that CPM exchanged correspondence/legal notice with Tata Sons and also passed on information along with certain files, to the Income Tax authorities claiming to be a very "law abiding citizen".

16.17 Since the EGM of Tata sons was scheduled to be held on 06.02.2017, for considering the resolution for CPM's removal from the Directorship, the Companies (S.P. Group) which filed the complaint before the NCLT moved an interim application before NCLT for a stay of the EGM. NCLT declined stay and the appeal against the refusal to grant stay was also dismissed by NCLAT. Therefore, the EGM proceeded as scheduled on 06.02.2017 and CPM was removed from the Directorship of Tata Sons. In his place Mr. N. Chandrasekharan, was appointed as Executive Chairman. 16.18 In the Company Petition as it was originally filed on 20.12.2016, the complainant companies had sought a set of 21 reliefs, one of which was for a direction to the respondents (the company and its directors) not to remove CPM (who was cited as R 11 in the original petition) from the directorship of Tata Sons. This was in prayer clause (F) of Paragraph 153 of the main company petition. This prayer was in direct contrast to the reliefs sought in prayer clauses (A) and (B). Prayer clause (A) was for superseding the existing Board of Directors and appointment of an Administrator. Prayer in clause (B) was for appointment of a retired Supreme Court Judge as Non Executive Chairman and for appointment of a new set of independent Directors.

16.19 After the dismissal of the interim application moved for stalling the EGM scheduled to be held on 06.02.2017 and after the passing of the resolution for the removal of CPM in the EGM held on 06.02.2017, the complainant companies moved an application for amendment of the original petition so as to include two additional prayers namely (i) reinstatement of the

representative of the complainant companies on the Board of Tata Sons; and (ii) amendment of the Articles of Association to provide for proportional representation.

16.20. However, eventually the prayers made in clauses (A), (B) and (C) were not pressed. Prayers in clauses (F), (Q) & (R) were also not pressed on the ground that they had become infructuous. In Paragraph 3.4 above we have extracted the reliefs as originally sought in the main company petition and in the table in Paragraph 4.11 we have indicated the prayers additionally made and the reliefs either given up or sought to be modified.

16.21 In fact the real reason why the complainant companies thought fit, quite tactfully, not to press for the reinstatement of CPM is that the mere termination of Directorship cannot be projected as something that would trigger the just and equitable clause for winding up or to grant relief under Sections 241 and 242. A useful reference can be made in this regard to the decision of this Court in ***Hanuman Prasad Bagri & Ors. vs. Bagress Cereals Pvt. Ltd.***, (2001) 4 SCC 420.

16.22 It must be remembered : (i) that a provision for inclusion of a representative of small shareholders in the Board of Directors, is of a recent origin under Section 151 of the Companies Act, 2013 and it is applicable only to a listed company; (ii) that Tata sons is not a listed Company; (iii) that the Articles of Association of Tata sons, to which the complainant companies, CPM and his father had subscribed, do not provide for any representation; (iv) that despite there being no statutory or contractual obligation, Tata Sons inducted CPM's father as a director on the board in the year 1980 and continued him for a period of almost 25 years; (v) that CPM himself was inducted, again without reference to any statutory or contractual obligation, as a Director on the Board in August, 2006; and (vi) that within 6 years of such induction, CPM was identified as a successor to RNT and was appointed as Executive Deputy Chairman and elevated to the position of Executive Chairman. 16.23 It is an irony that the very same person who represents shareholders owning just 18.37% of the total paid up share capital and yet identified as the successor to the empire, has chosen to accuse the very same Board, of conduct, oppressive and unfairly prejudicial to the interests of the minorities. In support of such allegation, the complainant companies have pointed out certain business decisions taken during the period of more than 10 years immediately preceding the date of removal of CPM. That failed business decisions and the removal of a person from Directorship can never be projected as acts oppressive or prejudicial to the interests of the minorities, is too well settled. In fact it may be concede today by Tata sons that one important decision that the Board took on 16.03.2012 certainly turned out to be a wrong decision of a life time.

16.24 Therefore, the fact that the removal of CPM was only from the Executive Chairmanship and not the Directorship of the company as on the date of filing of the petition and the fact that in law, even the removal from Directorship can never be held to be an oppressive or prejudicial conduct, was sufficient to throw the petition under section 241 out, especially since NCLAT chose not to interfere with the findings of fact on certain business decisions.

16.25 The subsequent conduct on the part of CPM in sending replies to the Income Tax Authorities enclosing 4 box files, even while continuing as a Director, justified his removal even from the Directorship of Tata Sons and other group companies. It is perhaps this realisation that made the complainant companies give up their original prayer for restraining the company from removing CPM and singing a different tune seeking proportionate representation on the Board.

16.26 For assailing the decision to remove CPM from the Chairmanship of Tata Sons, it is contended (i) that Tata Group performed exceedingly well under his stewardship; (ii) that the Nomination and Remuneration Committee for the Financial Year 201516 endorsed his performance and even recommended a pay hike and performance linked bonus; and (iii) that the Board unanimously approved these recommendations on 29.6.2016 just four months before his unceremonious removal.

16.27 First of all, the above contention is in direct conflict with the entire foundation on which the whole case of the complainant companies was erected. If CPM and the members of the Nomination and Remuneration Committee as well as the entire Board were on the same page till 29.6.2016 that the company was doing well under the stewardship of CPM, then there can be no allegation that the company's affairs were conducted in a manner oppressive or prejudicial to the interest of anyone, namely the company or the minority, at least until 29.6.2016. On the contrary if the company's affairs have been conducted in a manner oppressive or prejudicial, even before 29.6.2016, the other members of the Board and CPM could not have formed themselves into a mutual admiration society to laud CPM's performance and CPM acknowledging that the company was doing well when he was in the driver's seat.

16.28 An important aspect to be noticed is that in a petition under Section 241, the Tribunal cannot ask the question whether the removal of a Director was legally valid and/or justified or not. The question to be asked is whether such a removal tantamount to a conduct oppressive or prejudicial to some members. Even in cases where the Tribunal finds that the removal of a Director was not in accordance with law or was not justified on facts, the Tribunal cannot grant a relief under Section 242 unless the removal was oppressive or prejudicial.

16.29 There may be cases where the removal of a Director might have been carried out perfectly in accordance with law and yet may be part of a larger design to oppress or prejudice the interests of some members. It is only in such cases that the Tribunal can grant a relief under Section 242. The Company Tribunal is not a labour Court or an administrative Tribunal to focus entirely on the manner of removal of a person from Directorship. Therefore, the accolades received by CPM from the Nomination and Remuneration Committee or the Board of Directors on 29.6.2016, cannot advance his case.

16.30 A contention was raised that CPM's removal was a pre meditated act, carried out at the behest of Tata Trusts and RNT and that the removal was not only contrary to Article 118, but

also contrary to Article 105(a) read with the second proviso to Section 179(1) and Article 122(b).

16.31 As we have pointed out above, the validity of and justification for the removal of a person can never be the primary focus of a Tribunal under Section 242 unless the same is in furtherance of a conduct oppressive or prejudicial to some of the members. In fact the post of Executive Chairman is not statutorily recognised or regulated, though the post of a Director is. At the cost of repetition it should be pointed out that CPM was removed only from the post of (or designation as) Executive Chairman and not from the post of Director till the Company Petition was filed.

16.32 It is true that as per the evidence available on record he was requested before the Board meeting, to step down from the post of Executive Chairman. That does not tantamount to the act being premeditated. The induction of new members on 8.8.2016 into the Board and the Board securing a legal opinion prior to the Board meeting, cannot make the act a premeditated one. There is a thin line of demarcation between a well conceived plan and a pre meditated one and the line can many times be blurred.

16.42 In any event the removal of a person from the post of Executive Chairman cannot be termed as oppressive or prejudicial. The original cause of action for the complainant companies to approach NCLT was the removal of CPM from the post of Executive Chairman. Though the complainant companies padded up their actual grievance with various historical facts to make a deceptive appearance, the *causa proxima* for the complaint was the removal of CPM from the office of Executive Chairman. His removal from Directorship happened subsequent to the filing of the original complaint and that too for valid and justifiable reasons and hence NCLAT could not have laboured so much on the removal of CPM, for granting relief under Sections 241 and 242.

Invocation of just and equitable clause

16.43 Interestingly, NCLAT has recorded a finding, though not based upon any factual foundation, that the facts otherwise justify the making of a winding up order on just and equitable ground. But as held by the Privy Council in ***Loch v. John Blackwood,*** [1924] AC 783 , "there must lie a justifiable lack of confidence in the conduct and management of the company's affairs, at the foundation of applications for winding up." More importantly, "the lack of confidence must spring not from dissatisfaction at being outvoted on the business affairs or on what is called the domestic policy of the company". But, "wherever the lack of confidence is rested on a lack of probity in the conduct of the company's affairs, then the former is justified by the latter."

16.44 A passage from the opinion of Lord President of the Court of Session (Lord Clyde) in ***Baird v. Lees***, (1924) SC 83 Scottish Supreme Court quoted in **Loch** (supra), reads as follows: "A shareholder puts his money into a company on certain conditions. The first of

them is that the business in which he invests shall be limited to certain definite objects. The second is that it shall be carried on by certain persons elected in a specified way. And the third is that the business shall be conducted in accordance with certain principles of commercial administration defined in the statute, which provide some guarantee of commercial probity and efficiency. If shareholders find that these conditions or some of them are deliberately and consistently violated and set aside by the action of a member and official of the company who wields an overwhelming voting power, and if the result of that is that, for the extrication of their rights as shareholders, they are deprived of the ordinary facilities which compliance with the Companies Acts would provide them with, then there does arise, in my opinion, a situation in which it may be just and equitable for the Court to wind up the company."

16.45 If the above tests are applied, the case on hand will not fall anywhere near the just and equitable standard, for the simple reason that it was the very same complaining minority whose representative was not merely given a berth on the Board but was also projected as the successor to the Office of Chairman.

16.46 In ***Ebrahimi v. Westbourne Galleries Ltd.***, [1972] 2 WLR 1289 decided by House of Lords, one of the Directors who was voted out of office by the other two Directors (father-son duo) petitioned for an order under Section 210 of the English Companies Act, 1948. The very relief sought by the ousted director was for a direction to the other two persons to purchase his shares in the Company or to sell their shares to him on such terms as the Court should think fit. Alternatively, he prayed for winding up. The Court of the first instance held that a case for winding up had been made out, as the majority was guilty of abuse of power and a breach of good faith which the partners owed to each other not to exclude one of them from all participation in the business. The court of Appeal reversed it by applying the tests of (i) bonafide exercise of power in the interest of the company; and (ii) whether a reasonable man could think that the removal was in the interest of the Company. While reversing the decision of the Court of Appeal, the House of Lords held, that ***"the formula 'bonafide interest of the company' should not become little more than an alibi for a refusal to consider the merits of the case."*** Holding that, ***"equity always does enable the Court to subject the exercise of legal rights to equitable considerations namely considerations that is of a personal character"***, the House of Lords added some caution in the following words: *"The superimposition of equitable considerations requires something more, which typically may include one, or probably more, of the following elements: (i) an association formed or continued on the basis of a personal relationship, involving mutual confidence – this element will often be found where a preexisting partnership has been converted into a limited company; (ii) an agreement, or understanding, that all, or some (for there may be "sleeping" members), of the shareholders shall participate in the conduct of the business; (iii) restriction upon the transfer of the members' interest in the company – so that if confidence is lost, or one member is removed from management, he cannot take out his stake and go elsewhere."*

16.47 But it must be remembered that the origin of just and equitable clause is to be traced to the Law of Partnership which has developed, according to the House of Lords, "the

conceptions of probity, good faith and mutual confidence". Having said that, ***Ebrahimi*** pointed out that the reference to quasi partnerships or "insubstance partnerships" is also confusing for the reason that though the parties may have been partners in their *'Purvashrama'*, they had become co-members of a company accepting new obligations in law. Therefore, ***"a company, however small, however domestic, is a company and not a partnership or even a quasi partnership"***.

16.48 That, "for superimposing an equitable fetter on the exercise of the rights conferred by the Articles of Association, there must be something in the history of the company or the relationship between the shareholders", is fairly well settled [Re Saul D. Harrison and Sons Plc. 1994 BCC 475].

16.49 In ***Lau v. Chu***, [2020] 1 WLR 4656 the House of Lords indicated, "that a just and equitable winding up may be ordered where the company's members have fallen out in two related but distinct situations, which may or may not overlap". The first of these is labelled as, "functional dead lock", where the inability of members to cooperate in the management of the company's affairs leads to an inability of the company to function at Board or shareholder level. The House of Lords pointed out that functional dead lock of a paralysing kind was first clearly recognised as a ground for just and equitable winding up ***In Re Sailing Ship Kentmere Co***., [1897] WN 58. The second of these is where a company is a corporate quasi partnership and an irretrievable breakdown in trust and confidence between the participating members has taken place. In the first type of these cases, where there is a complete functional dead lock, winding up may be ordered regardless whether the company is a quasi partnership or not. But in the second type of cases, a breakdown of trust and confidence is enough even if there is not a complete functional dead lock.

16.50 Therefore, for invoking the just and equitable standard, the underlying principle is that the Court should be satisfied either that the partners cannot carry on together or that one of them cannot certainly carry on with the other [footnote appended: The advantage that the English courts have is that irretrievable breakdown of relationship is recognised as a ground for separation both in a matrimonial relationship and in commercial relationship, while it is not so in India.].

16.51 In the case in hand there was never and there could never have been a relationship in the nature of quasi partnership between the Tata Group and S.P. Group. S.P. Group boarded the train halfway through the journey of Tata Sons. Functional dead lock is not even pleaded nor proved.

16.52 Coming to the Indian cases, this court held in ***Rajahmundry Electric Supply Corpn. Ltd. v. Nageshwara Rao,*** (1955) 2 SCR 1066 that for the invocation of just and equitable clause, there must be a justifiable lack of confidence on the conduct of the directors, as held. A mere lack of confidence between the majority shareholders and minority shareholders would not be sufficient, as pointed out in ***S.P. Jain v. Kalinga Tubes Ltd.,*** AIR 1965 SC

1535 The advantage that the English courts have is that irretrievable breakdown of relationship is recognised as a ground for separation both in a matrimonial relationship and in commercial relationship, while it is not so in India.

16.53 It was contended repeatedly that lack of probity in the conduct of the directors is a sufficient cause to invoke just and equitable clause. Drawing our attention to the landmark decision in ***Needle Industries (India) Ltd. and Ors. v. Needle Industries Newey (India) Ltd. and ors.,*** (1981) 3 SCC 333 it was contended that even the profitability of the company has no bearing if just and equitable standard is fulfilled and that the test is not whether an act is lawful or not but whether it is oppressive or not.

16.54 But all these arguments lose sight of the nature of the company that Tata Sons is. As we have indicated elsewhere, Tata Sons is a principal investment holding Company, of which the majority shareholding is with philanthropic Trusts. The majority shareholders are not individuals or corporate entities having deep pockets into which the dividends find their way if the Company does well and declares dividends. The dividends that the Trusts get are to find their way eventually to the fulfilment of charitable purposes. Therefore, NCLAT should have raised the most fundamental question whether it would be equitable to wind up the Company and thereby starve to death those charitable Trusts, especially on the basis of uncharitable allegations of oppressive and prejudicial conduct. Therefore, the finding of NCLAT that the facts otherwise justify the winding up of the Company under the just and equitable clause, is completely flawed.

17. Question of Law No.2

17.1 The second question of law arising for consideration is as to whether the reliefs granted and directions issued by NCLAT including the reinstatement of CPM into the Board of Tata Sons and other Tata Companies are in consonance with (i) the pleadings made, (ii) the reliefs sought and (iii) the powers available under Sub-Section (2) of Section 242.

17.2 As we have indicated in Para 3.4 above, the complainant companies originally sought a set of 21 reliefs listed in para 153 (A) to (U). Subsequently, the complainant companies sought the addition of two more prayers, through an application for amendment filed on 10.2.2017. The additional reliefs sought to be included were for: (i) reinstatement of a representative of the complainant companies on the Board of Tata Sons and (ii) Amendment of the Articles of Association so as to provide for proportional representation on the Board.
17.3 Thereafter the complainant companies sought a few more prayers through an application for amendment dated 31.10.2017. However, by a Memo dated 12.01.2018 the complainant companies gave up certain prayers, sought a modification of some other prayers and recorded that they were not pressing certain reliefs.

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17.6 Thus NCLAT granted to the complainant companies (and indirectly to CPM) four reliefs namely:

(i) reinstatement of CPM;

(ii) declaring Tata Sons as a Public Limited Company;

(iii) restraining the nominee Directors and RNT from taking any decision in advance and

(iv) restraining the invocation of Article 75 except in exceptional circumstances.

We shall now see whether NCLAT could have granted any of these reliefs.

Reinstatement of CPM

17.7 Removal and reinstatement are two different things. We have dealt with the issue of removal of CPM, while answering question of law No.1, in the context of whether it was part of a scheme of oppressive and prejudicial conduct. Now we shall deal with the issue of reinstatement in the context of the contours of section 242(2) and the nature of the orders that could be passed.

17.8 As we have seen already, the original motive of the complainant companies, was to restrain Tata Sons from removing CPM as Director. Subsequently, there was a climb down and the complainant companies sought what they termed as "reinstatement" of a representative of the complainant companies. Thereafter, it was modulated into a cry for proportionate representation on the Board.

17.9 In this background it was repeatedly argued both before the NCLAT and before this Court that the objective of the litigation was not to have CPM reinstated, but only to set things right in the State of Denmark (of which CPM himself was the Premier for 4 years). But interestingly, NCLAT understood what the complainant companies and CPM actually wanted, though they attempted to camouflage their intentions with legal niceties. Therefore, despite there being no prayer for reinstatement of CPM either as a Director or as an Executive Chairman of Tata Sons, NCLAT directed the restoration of CPM as Executive Chairman of Tata Sons and as Director of Tata Companies for the rest of the tenure.

17.10 While granting much more than what the complainant companies and CPM themselves thought as legally feasible, NCLAT failed to notice one important thing. The appointment of CPM as Executive Deputy Chairman of Tata Sons, was to be for a period of 5 years from 01.04.2012 to 31.03.2017, subject to the approval of the shareholders. In the Meeting of the shareholders held on 01.08.2012, the appointment of CPM as Executive Deputy Chairman was approved and the General Body left it to the Board to redesignate CPM as Chairman.

Accordingly, the Board re designated CPM as Executive Chairman, with effect from 29.12.2012, by a resolution passed on 18.12.2012.

17.11 The judgment of the NCLAT was passed on 18.12.2019, by which time, a period of nearly 7 years had passed from the date of CPM's appointment as Executive Chairman. Therefore, we fail to understand : (i) as to how NCLAT could have granted a relief not apparently sought for (though wished for); and (ii) what NCLAT meant by reinstatement "for the rest of the tenure". That the question of reinstatement will not arise after the tenure of office had run its course, is a settled position. In this regard, we may refer to the decisions in ***Raj Kumar Dey vs. Tarapada Dey***, (1987) 4 SCC 398 and ***Mohd. Gazi vs. State of Madhya Pradesh,*** (2000) 4 SCC 342**.** While so, it is incomprehensible that the NCLAT directed reinstatement, and that too, of a Director of a company, after the expiry of his term of office. Needless to say that such a remedy would not have been granted even by a labour court/service Tribunal in matters coming within their jurisdiction.

17.12 In fact NCLAT has gone to the extent of reinstating CPM not only on the Board of Tata Sons, but also on the Board of Tata group companies, without they being parties, without there being any complaint against those companies under section 241 and without there being any prayer against them. These companies have followed the procedure prescribed by Statute and the Articles and they have validly passed resolutions for his removal. For instance, TCS granted an opportunity to CPM and held a general meeting in which 93.11% of the shareholders, including public institutions who hold 57.46% of shares supported the resolution. In any case CPM's tenure itself was to come to an end on 16.06.2017 but NCLAT passed the impugned order reinstating him "for the rest of the tenure". In respect of other companies which had convened the EGM for considering the resolution for his removal, CPM submitted resignations. But now by virtue of the impugned order, CPM will have to be reinstated even on the Board of companies from which he has resigned. This is why even the complainant companies have found it extremely difficult to support the order.

17.13 As an aside, we should record here, the words of gratitude (if any) expressed by CPM himself in the meeting of the Board of Tata Sons on 18.12.2012, immediately after the resolution appointing him as Executive Chairman was carried through unanimously. This is what CPM said in the Board Meeting dated 18.12.2012: "Mr. Mistry responded by saying that – "the past one year has been a great learning experience under the direct guidance of Mr. Ratan Tata. The TATA Group is founded on strict values. We will face all the ups and down, whatever may lie in our path. We are ready to face all the challenges that will come our way. The Board recognises the stellar contribution of Mr. Ratan Tata and wishes, to designate him Chairman Emeritus. We shall continue to seek his guidance on significant matters."

17.14 It is interesting to note that at the time of his appointment in December 2012, what CPM saw and acknowledged, was a "great learning experience he had under the direct guidance of RNT", but at the time of departure in October 2016, what he saw was only a conduct for over 10 years, that was oppressive and prejudicial to the interests of the company

and of the minority. NCLAT failed to take note of this, while granting reliefs neither sought for nor feasible in law.

17.15 NCLAT appears to have granted the relief of reinstatement gratis without any foundation in pleadings, without any prayer and without any basis in law. By doing so, the NCLAT has forced upon the appellant an Executive Chairman, who now is unable to support his own reinstatement.

17.16 The NCLAT has found the dismissal to be illegal and not a nullity. In law, a dismissal even if found to be wrongful and malafide is an effective dismissal and may give rise to a claim in damages. In ***Dr. S.B. Dutt vs. University of Delhi,*** 1959 SCR 1236 this Court held: *"The award held that the appellant had been dismissed wrongfully and malafide. Now, it is not consequential to such a finding that the dismissal was of no effect, for a wrongful and malafide dismissal is nonetheless an effective dismissal though it may give rise to a claim in damages. The award, no doubt, also said that the dismissal of the appellant was ultravires but as will be seen later, it did not thereby hold the act of dismissal to be a nullity and, therefore, of no effect."*

17.17 It is significant that Sections 241 and 242 of the Companies Act, 2013 do not specifically confer the power of reinstatement, nor we would add that there is any scope for holding that such a power to reinstate can be implied or inferred from any of the powers specifically conferred.

17.18 The following words at the end of subsection (1) of 242 "the Tribunal may, with a view to bringing to an end the matters complained of, make such order as it thinks fit" cannot be interpreted as conferring on the Tribunal any implied power of directing reinstatement of a director or other officer of the company who has been removed from such office. These words can only be interpreted to mean as conferring the power to make such order as the Tribunal thinks fit, where the power to make such an order is not specifically conferred but is found necessary to remove any doubts and give effect to an order for which the power is specifically conferred. For instance, subsection (2) of Section 242 confers the power to make an order directing several actions. The words by which subsection (1) of Section 242 ends, *supra* can be held to mean the power to make such orders to bring an end, matters for which directions are given under subsection (2) of Section 242.

17.19 The architecture of Sections 241 and 242 does not permit the Tribunal to read into the Sections, a power to make an order (for reinstatement) which is barred by law vide Section 14 of the Specific Relief Act, 1963 with or without the amendment in 2018. Tribunal cannot make an order enforcing a contract which is dependent on personal qualifications such as those mentioned in Section 149(6) of the Companies Act, 2013.

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19. <u>Question 4</u>

19.1 The fourth question of law to be considered is whether the characterisation by the Tribunal, of the affirmative voting rights available under Article 121 to the Directors nominated by the Trusts in terms of Article 104B, as oppressive and prejudicial, is justified especially after the challenge to these Articles have been given up expressly and whether the Tribunal could have granted a direction to RNT and the Nominee directors virtually nullifying the effect of these Articles.

19.2 In the Company Petition as it was originally filed, the complainant companies sought a prayer in Paragraph 153(M) to strike down Articles 86, 104B, 118, 121 and 121A in entirety and to strike off one portion of Article 124. These Articles (other than Article 118, which is extracted elsewhere) read as follows: "86. Quorum at General Meetings No quorum at a general meeting of the holders of the Ordinary Shares of the Company shall be constituted unless the members who are personally present are not less than five in number including at least one authorised representative jointly nominated by the Sir Dorabji Tata Trust and the Sir Ratan Tata Trust so long as the Tata Trusts hold in aggregate at least 40% of the paid-up Ordinary share capital, for the time being, of the Company.

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104. General Provisions A. Number of Directors .....

B. Nomination of Directors So long as the Tata Trusts own and hold in the aggregate at least 40% of the paid up Ordinary share capital, for the time being, of the company, the Sir Dorabji Tata Trust and Sir Ratan Tata Trust, acting jointly, shall have the right to nominate one third of the prevailing number of Directors on the Board and in like manner to remove any such person so appointed and in place of the person so removed, appoint another person as Director.

The Directors so nominated by the Sir Dorabji Tata Trust and Sir Ratan Tata Trust shall be appointed as Directors of the Company.

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121. Matters How Decided.

Matters before any meeting of the Board which are required to be decided by a majority of the directors shall require *the affirmative vote of a majority of the Directors appointed pursuant

to Article 104B present at the meeting and in the case of an equality of vote's the Chairman shall have a casting vote." **121A. The following matters shall be resolved upon by the Board of Directors:

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19.3 But through a Memo dated 12.01.2018, the complainant companies restricted the relief prayed in Paragraph 153(M) to the extent as follows:

(i) the necessity of affirmative voting of the majority of the Directors nominated by the Trusts, which are majority of shareholders be deleted;

(ii) the petitioners be entitled to proportionate representation on the Board of Directors of Respondent No.1;

(iii) the petitioners be entitled to a representation on all committees formed by the Board of Directors of Respondent No.1; and

(iv) the Articles of Association be amended accordingly. 19.4 Therefore, what was actually sought by the complainant companies was the deletion of the Article that necessitated the affirmative voting right of the majority of the Directors nominated by the two Trusts. There was no prayer for restraining RNT and the nominee Directors of the Trusts from taking any decision in advance.

19.5 In fact, even the complainant companies are not happy about the relief so granted by NCLAT. In the Table given in Paragraph 4 of their Memorandum of Appeal in C.A.No.1802 of 2020, the complainant companies themselves seek a modification of the relief so granted.

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19.6 But for the fact that the complainant companies have also come up with an appeal, we would have simply set aside the order of restraint passed by NCLAT against RNT and nominee Directors, on the ground that there was no such prayer. Now that S.P. Group has come up with an appeal seeking an amplification or modulation of the relief so granted, we shall deal with the challenge to the affirmative voting rights.

Affirmative voting rights

19.7 Under Article 104B, Sir Dorabjee Tata Trust and Sir Ratan Tata Trust, acting jointly, shall have a right to nominate 1/3rd of the prevailing number of Directors on the Board, so long as the Trusts own and hold, in the aggregate, at least 40% of the paid up share capital. Article 121 provides that the matters which require to be decided by a majority of the

Directors, shall require the affirmative vote of the majority of Directors appointed under Article 104B.

19.8 Article 121A contains the list of matters to be resolved by the Board of Directors. One of the items included therein is "any matter affecting the share holding of the Tata Trusts in the Company…" 19.9 As seen from the Table under Paragraph 4 of the Memorandum of appeal filed by the S.P. Group in C.A.No.1802 of 2020, they are not seeking, even now, the scrapping of the affirmative voting rights. Interestingly, S.P. Group, through their Memo dated 12.01.2018 wanted the deletion of the Article providing for affirmative voting right. But as per the Table under Paragraph 4 of the Memo of their appeal in C.A.No.1802 of 2020, the complainant companies have now reconciled themselves to the unavoidability of affirmative voting rights but all that they want is that the applicability of affirmative voting right should be restricted to the matters covered by Article 121A. In addition, the complainant companies want a similar affirmative right to be conferred on the nominee Directors of the S.P. Group.

19.10 The swing that the S.P. Group has taken in their position relating to affirmative voting rights is quite funny. To begin with, they sought a prayer for striking off Article 121 in its entirety. Later they restricted their relief, by the Memo dated 12.01.2018, to the deletion of "the necessity of affirmative voting rights". But now they are fine with the existence of affirmative voting rights for the majority in respect of matters covered by Article 121A, but want a similar right in favour of the nominee directors of the S.P. Group. 19.11 The frequent change of position that S.P. Group has taken and the relief that they now seek, raises a doubt whether it is actually a fight on principles. If affirmative voting rights are bad in principle, we do not know how they may become good, if conferred on S.P. Group also.

19.12 Drawing our attention to Sections 135, 149, 151, 161 166 and 177 of the Companies Act, 2013, it was argued on behalf of SP group that there is a sea change in the law, after the advent of the 2013 Act and that today a paradigm shift has taken place from 'corporate majority/democracy' to 'corporate governance' and that every action of the Board has to pass the test of fairness. It is further contended that Directors have a fiduciary responsibility with the highest level of duty and that the same cannot be outsourced. According to the SP group, the Directors, once appointed, owe their allegiance only to the company and not to their nominators.

19.13 At first blush, these arguments, almost bordering on romantic idealism, appear very attractive. But on a deeper scrutiny, they are bound to get grounded. If we have a look at the history of evolution of corporate enterprises, it can be seen that there are 3 time periods through which development of corporate entities have passed. In the first period, large corporate houses were established by individuals with their own funds and those individuals and their families controlled both ownership and management of these enterprises. In the second time period, when professionalism became the '*Taraka mantra*', families which promoted enterprises, retained ownership, but appointed professional managers to run the show. Thus ownership got divested from management. In the third time period, social

participation increased by leaps and bounds through public issues and listing. This increased the social accountability and social responsibility of corporate entities. Every time a historical shift/change took place, the legal regime had to undergo a change, albeit at snail's pace.

19.14 As a matter of fact, the Companies Act, 1956 suffered 24 amendments. Major amendments were made first in 1988 and then in 2002, respectively on the basis of the recommendations of the Sachar Committee and the Report of the Eradi Committee. On August 4, 2004, the Ministry of Company Affairs, published a Concept Paper on Company Law on its website, after which, the Government constituted an Expert Committee under the Chairmanship of Dr. J.J. Irani20. The mandate of the Committee was to make recommendations on certain issues, one of which was "protecting the interests of stakeholders and investors, including small investors". This committee's report crystallised into 20 Incidentally J.J. Irani was the Chairman of Tata Sons for sometime Companies Bill, 2009, which later became Companies Bill, 2011 and then Companies Act, 2013.

19.14 It is true that the 2013 Act brought a lot of drastic changes. Some of the salient features of the 2013 Act are:

(i) Every company is required to have at least one Director who has stayed in India for a total period of not less than 182 days in the previous calendar year.

(ii) Every listed Public Company is required to have at least onethird of the total number of Directors as independent Directors.

(iii) Some Public Companies are required to have at least two independent Directors.

(iv) Every independent Director should give a declaration at the first Board meeting that he meets the criteria of independence.

(v) Certain types of Public Companies are required to appoint at least one woman Director.

(vi) Every listed company may appoint a small shareholders' Director, to be elected by the small shareholders.

(vii) The report of the Board of Directors should include a Director's Responsibility Statement, covering certain aspects relating to accounting standards, accounting policies and maintenance of accounting records.

(viii) Directors of a company are obliged to perform certain duties, such as duty to act in good faith, duty to exercise reasonable care, skill diligence and independent Judgment etc.

(ix) A detailed Code of conduct for independent Directors is stipulated in Schedule IV. This includes guidelines for professional conduct, roles and functions and duties.

(x) The resignation or removal of independent Directors should be in accordance with the procedure prescribed.

(xi) Independent Directors are required to hold at least one meeting in a year without the attendance of non independent Directors and members of management and they are entitled in this meeting to review the performance of nonindependent Directors and the Board as a whole. They can even review the performance of the Chairperson of the Company and assess the quality, quantity and timeliness of flow of information between the management and the Board.

(xii) The Board of Directors of certain companies are required to have certain Committees such as (1) Audit Committee; (2) Nomination and Remuneration Committee and (3) Stakeholders Relationship Committee.

(xiii) A separate section on Corporate Governance is to be included in the Annual Reports of certain companies, with a detailed compliance Report on Corporate Governance.

(xiv) After the advent of the Companies Act, 2013, SEBI Regulations were also amended, inserting Clause 49 in the Listing Agreement, to enforce compliance with Corporate Governance standards.

19.15 But it must be remembered that the shift under the Companies Act, 2013 is focused on listed and unlisted public companies. The requirement under Section 149(4) to have at least one-third of the total number of Directors as independent Directors applies only to every listed public company. The requirement under Section 151 to have one Director elected by small shareholders is also applicable only to listed companies. The requirement to constitute an Audit Committee in terms of Section 177(1), a Nomination and Remuneration Committee and the Stakeholders Relationship Committee in terms of Section 178(1) are also only on listed public companies.

19.16 Insofar as Tata Sons is concerned, the Articles of Association of the Company continue to contain the prescribed restrictions which make it a private company within the definition of the expression under Section 2(68). Therefore, the provisions discussed above do not apply to Tata Sons. Yet Tata Sons has a Board packed with many people who are ranked outsiders. If the idea was to run Tata Sons purely as a family business, RNT need not have stepped down from the Chairmanship. Today nobody wants to step down from any office, except if afflicted by brain stroke or sun stroke. As we have seen from the pleadings, the Tata Group was founded by Jamsetji Nusserwanji Tata (1839-1904). It was first established as a private trading firm in 1868 and was later incorporated as a private company on 8.11.1917 under Section 2(13) of the Companies Act, 1913. Later two Trusts were created, one in the year 1919 under the name Sir Ratan Tata Trust and another in 1952 under the name Sir Dorabji Tata Trust. It was only in 1965 that S.P. Group acquired 48 preference shares and 40 equity shares, from a member of Tata Sons named Mrs. Rodabeh Sawhney. Shri Pallonji Mistry, the father of CPM was inducted as a NonExecutive Director on 25.06.1980, though the Articles of Association did not confer any right of Directorship upon the S.P Group. He stepped down from this position in December, 2004. Thereafter, CPM was appointed as Non-

Executive Director on 10.08.2006. Ever since the establishment of the Tata Group in 1868, there have only been six persons who became the Chairmen of the Group. While five of them namely Jamshedji Tata, Sir Dorab Tata, Nowroji Saklatwala, JRD Tata and Ratan Tata belonged to the same family, the sixth person namely CPM was inducted as Executive Chairman by Resolution dated 18.12.2012 with effect from 29.12.2012. Before the said appointment, CPM was identified by a Selection Committee which comprised of the nominees of the two Tata Trusts. This Selection Committee identified CPM as a successor to RNT as Chairman and appointed him first as Executive Deputy Chairman for a period of five years form 1.04.2012 till 31.03.2017, subject to the approval of the General Body. The General meeting of the shareholders, held on 1.8.2012 approved the appointment of CPM as Executive Deputy Chairman and also left it to the Board to redesignate him as Chairman. This is how the Board, in its meeting dated 18.12.2012 redesignated CPM as Executive Chairman.

19.17 If the argument relating to corporate governance is carefully scrutinized in the context of the fact: (i) that a large industrial house whose origin and creation was familial, was willing to handover the mantle of heading the entire empire to a person like CPM (a rank outsider to the family); and (ii) that the identification of CPM as the successor to RNT was done by the very same nominees of the two Tata Trusts (who is now accused of interference), then it will be clear that Tata Group was guided by the principle of Corporate Governance (even without a statutory compulsion) and not by tight-fisted control of the management of the affairs of the Group.

19.18 The provisions of sections 135, 149, 151, 166 and 177 around which the argument relating to corporate governance is fantasised, cannot advance the case of the SP group. Section 135 deals with corporate social responsibility, which in any case is more pronounced in this company due to the fact that charitable trusts hold majority of the shares. Section 149 deals with the requirement to have Directors, section 151 provides for appointment of a Director elected by small shareholders, section 166 enumerates the duties of directors and section 177 and 178 speak of some committees. Some of these provisions such as sections 151, 177 and 178 apply only to listed public companies. Yet, Tata Sons have complied with sections 177 and 178 by constituting necessary committees.

19.19 It was contended that a Director of a Company is to act in good faith in order to promote the objects of the Company for the benefit of all the stakeholders and that he is in a fiduciary capacity visavis the company. The affirmative voting rights, according to S.P.Group, disabled the nominee Directors from acting independently in the best interests of the company and its stakeholders and that once appointed, the loyalty of the nominee Directors should be to the Company and not solely to the Trusts which nominated him. It was further contended that under Articles 121, 121A and 122, Tata Sons was to be a Board managed Company and that the protective rights conferred under Article 121 were intended to take care of the interests of the Tata Trust, in case they became a minority.

19.20 According to the S.P. Group, the pre-consultation/pre-clearance requirement disabled the Directors from effectively discharging their fiduciary duties under Section 166, violated the Secretarial Standards required to be adhered to under Section 118(10) and rendered nugatory, the scheme of Section 149 which requires 1/3rd of the members of the Board to be independent Directors.

19.21 But all the above contentions are completely devoid of any substance, for they tend to overlook one basic fact namely that Tata Sons is not a company engaged either in any manufacturing activity or in any trading activity. As per the pleadings, on which there is no dispute, Tata Sons is a Principal Investment Holding Company and is a promoter of Tata Companies. Tata Sons holds a controlling interest in all the operating companies of the Tata Group. Other than being the Principal Investment Holding Company, Tata Sons, by itself is not engaged in any direct business activity.

19.22 As we have indicated in the beginning, around 66% of the equity share capital of Tata Sons is held by philanthropic Trusts, including Sir Dorabji Tata Trust and Sir Rata Tata Trust. It is claimed that these charitable Trusts support education, health, livelihood generation and Art & Culture.

19.23 If we take these two important factors into consideration namely: (i) that Tata Sons is only a Principal Investment Holding Company; and (ii) that the majority shareholders of Tata Sons are only philanthropic charitable Trusts, it will be clear that the Directors nominated by the Trusts are not like any other Directors who get appointed in a General Meeting of the Company in terms of Section 152(2) of the Act. In fact it is a paradox to claim that by virtue of Subsections (2) and (3) of Section 166, every Director of a Company is duty bound to act in good faith in order to promote the objects of the company for the benefits of its members and in the best interests of all the stakeholders as well as environment and a duty to exercise independent judgment, and yet mandate the appointment of independent Directors under Section 149(4). If all Directors are required under Section 166(3) to exercise independent Judgment, we do not know why there is a separate provision in Section 149(4) for every listed Public Company to have at least 1/3rd of the total number of Directors as independent Directors. We do not also know whether the prescription in Section 149(4) is a tacit acknowledgment that all the Directors appointed in a General meeting under Section 152(2) may not be independent in practice, though they may be required to be so in theory.

19.24 A person nominated by a charitable Trust, to be a Director in a company in which the Trust holds shares, also holds a fiduciary relationship with the Trust and fiduciary duty towards the nameless, faceless beneficiaries of those Trusts. As we have pointed out elsewhere, the history of evolution of the corporate world shows that it has moved from the (i) familial to (ii) contractual and managerial to (iii) a regime of social accountability and responsibility. This is why Section 166(2) also talks about the duty of a Director to protect environment, in addition to his duties to (i) promote the objects of the company for the benefit of its members as a whole; and (ii) act in the best interests of the company, its employees, the

shareholders and the community. It is common knowledge that some of the industries which take good care of its shareholders and employees also run polluting industries. Therefore there is always a conflict, a tug of war between competing interests and statutes cannot resolve these conflicts effectively. 19.25 Affirmative voting rights for the nominees of institutions which hold majority of shares in companies have always been accepted as a global norm. As a matter of fact the affirmative voting rights conferred by Article 121 of the Articles of Association, confers only a limited right upon the Directors appointed by the Trusts under Article 104B. Article 121 speaks only about the manner in which matters before any meeting of the Board shall be decided. If it is a General Meeting of Tata Sons, the representatives of the two Trusts will actually have a greater say as the Trusts have 66% of shares in Tata Sons. Therefore, if we apply Section 152(2) strictly, the Trusts which own 66% of the paid up capital of Tata Sons will be entitled to pack the Board with their own men as Directors. But under Article 104B, only a minimum guarantee is provided to the two Trusts, by ensuring that the Trusts will have at least 1/3 rd of the Directors, as nominated by them so long as they hold 40% in the aggregate of the paid up share capital.

19.26 Section 43 of the Companies Act (which is equivalent of Section 86 of the 1956 Act), recognises two types of share capital of a company limited by shares. They are (i) equity share capital; and

(ii) preference share capital. Again equity share capital can be of two kinds namely, (i) those with voting rights; and (ii) those with differential rights as to dividend, voting or otherwise in accordance with such rules as may be prescribed.

19.27 Section 47(1)(b) of the 2013 Act (equivalent to Section 87(1)(b) of the 1956 Act), declares that the rights of a member of a company limited by shares, shall be in proportion to his share in the paid up equity share capital of the company. This right is subject to the provisions of Section 43, Section 50(2) and Section 188(1) of the 2013 Act. The restrictions under Sections 43, 50(2) and 188(1) respectively are, (i) shares with differential voting rights;

(ii) disentitlement to voting rights, of a member who has not paid the unpaid share capital; and (iii) the disentitlement of a member to vote on a resolution for the approval of any contract entered into by the company with a related party.

19.28 Under Section 10(1) of the Companies Act, 2013, the Articles of Association bind the company and the members thereof to the same extent as if they respectively had been signed by the company and by each member. However, this is subject to the provisions of the Act.

19.29 Article 94 of the Articles of Association of Tata Sons is in tune with Section 47(1)(b), as it says that upon a poll, the voting rights of every member, whether present in person or by proxy shall be in proportion to his share of the paid up capital of the company. Therefore, a shareholder or a group of shareholders who constitute majority, can always seek to be in the driving seat by reserving affirmative voting rights. So long as these special rights are

incorporated in the Articles of Association and so long as they are not in contravention of any of the provisions of the Act, the same cannot be attacked on these grounds.

19.30 Coming to the argument revolving around the duty of a Director, it is necessary that we balance the duty of a Director, under Section 166(2) to act in the best interests of the company, its employees, the shareholders, the community and the protection of environment, with the duties of a Director nominated by an Institution including a public charitable trust. They have fiduciary duty towards 2 companies, one of which is the shareholder which nominated them and the other, is the company to whose Board they are nominated. If this is understood, there will be no confusion about the validity of the affirmative voting rights. What is ordained under Section 166(2) is a combination of private interest and public interest. But what is required of a Director nominated by a charitable Trust is pure, unadulterated public interest. Therefore, there is nothing abhorring about the validity of the affirmative voting rights.

21. Conclusion

Thus in fine, all the questions of law are liable to be answered in favour of the appellants Tata group and the appeals filed by the Tata Group are liable to be allowed and the appeal filed by S.P. Group is liable to be dismissed. But before we do that we should also deal with the application moved by S.P. Group before us during the pendency of these proceedings, praying for the alternative relief of directing Tata Sons and others to cause a separation of ownership interests of the S.P. Group in Tata sons through a scheme of reduction of capital by extinguishing the shares held by the S.P. Group in lieu of fair compensation effected through a transfer of proportionate shares of the underlying listed companies, with the balance value of unlisted companies and intangibles including brand value being settled in cash.

Interestingly, such an application was filed after Tata Group moved an application for restraining S.P. Group from raising money by pledging shares and this court passed an order of status quo on 22.09.2020. For the first time S.P. Group seems to have realized the futility of the litigation and the nature of the order that the Tribunal can pass under Section 242. This is reflected in Paragraph 62 of the application, where S.P. Group has stated that they are seeking such an alternative remedy as a means to put an end to the matters complained of.

As a matter of fact, S.P. Group should have sought such a relief from the Tribunal even at the beginning. As we have pointed out elsewhere a divorce without acrimony is what is encouraged both in England and in India under the statutory regime. 21.4 But in an appeal under Section 423 of the Companies Act, 2013, this Court is concerned with questions of law arising out of the order of NCLAT. Therefore, we will not decide this prayer. It should be pointed out at this stage that Article 75 of the Articles of Association is nothing but a provision for an exit option (though one may think of it as an expulsion option). After attacking Article 75 before NCLT, the S.P. Group cannot ask this Court to go into the question of fixation of fair value compensation for exercising an exit option. What is pleaded

in Paragraph 72 of the application for separation of ownership interests, require an adjudication on facts, of various items. The valuation of the shares of S.P. Group depends upon the value of the stake of Tata Sons in listed equities, unlisted equities, immovable assets etc., and also perhaps the funds raised by SP group on the security/pledge of these shares. Therefore, at this stage and in this Court, we cannot adjudicate on the fair compensation. We will leave it to the parties to take the Article 75 route or any other legally available route in this regard. 21.5 In the result, all the appeals except C.A. No.1802 of 2020 are allowed and the order of NCLAT dated 18.12.2019 is set aside. The Company Petition C.P. No. 82 of 2016 filed before NCLT by the two Companies belonging to the S.P. Group shall stand dismissed. The appeal C.A. No.1802 of 2020 filed by Cyrus Investments Pvt. Ltd., and Sterling Investments Corporation Pvt. Ltd. is dismissed. There will be no order as to costs.

All IAs including the one for causing separation of ownership interests of the S.P. Group in Tata Sons namely IA No.111387 of 2020, are dismissed.

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WINDING UP OF COMPANIES

In re German Date Coffee Company

(1882) 20 Ch. D. 169

The memorandum of association of a company stated that it was formed for working a German patent which had been or would be granted for manufacturing coffee from dates, and also for obtaining other patents for improvements and extensions of the said inventions or any modifications thereof or incident thereto; and to acquire or purchase any other inventions for similar purposes, and to import and export all descriptions of produce for the purpose of food, and to acquire or lease buildings either in connection with the above-mentioned purposes or otherwise, for the purposes of the company.

The intended German patent was never granted, but the company purchased a Swedish patent, and also established works in *Hamburg,* where they made and sold coffee made from dates without a patent. Many of the shareholders withdrew from the company on ascertaining that the German patent could not be obtained; but the large majority of those who remained desired to continue the company, which was in solvent circumstances.

A petition having been presented by two shareholders:

Held (affirming the decision of *Kay,* J.), that the substratum of the company had failed, and it was impossible to carry out the objects for which it was formed; and therefore that it was just and equitable that the company should be wound up, although the petition was presented within a year from its incorporation.

The effect of general words describing the objects of a company in the memorandum of association considered.

This was a petition for winding up the *German Date Coffee Company, Limited.*

The company was registered on the 16th of February, 1881, with a capital of £100,000, in shares of £1 each. By the memorandum of association the objects of the company were stated (so far as they are important for the present report) to be -

1. To acquire and purchase, and to use, exercise, and vend certain inventions for manufacturing from dates a substitute for coffee, for which a patent has or will be granted by the Empire of *Germany* to *Thomas Frederick Henley;* and also to acquire and purchase any other patents or privileges which may be granted to the said *Thomas Fredrick Henley,* his executors, administrators, or assigns, by the said Empire of *Germany;*
2. To make and use the said inventions, or any improvement therein, or modification thereof;
3. To adopt and carry out a certain agreement, dated the 16th of February, 1881, and made between the *Date Coffee Company, Limited,* of the one part, and *Richard Hillier,* for and on behalf of the company, of the other part;
4. To manufacture and sell the preparations which are the subject of the inventions;

5. To grant licenses for the manufacture of the said preparations and the sale thereof;

6. To apply for and obtain patents for improvements in or extensions of the said inventions, or any modifications thereof, or any matters in any way incidental thereto;

7. To acquire by purchase or otherwise, and to use, exercise, and vend any other inventions for the above-mentioned or cognate purposes;

8. To import all descriptions of produce for the purposes of food, and the exporting of the same, and the selling and disposing thereof respectively; and to acquire by purchase, or to lease or hire any land and buildings, steam-engines, &c., either in connection with the above-mentioned purposes or otherwise, for the purposes of the company or any company in the formation of which the company may have an interest.

The agreement of the 16th of February, 1881, referred to in the memorandum, was for the sale by the *Date Coffee Company* to *Hiller,* for £50,000, to be paid partly in cash and partly in shares of the *German Company,* of the rights, which the *Date Coffee Company* had, by an agreement dated the 17th of January, 1881, purchased from *T.F. Henley,* in certain patents for the invention of making from dates a substitute for coffee, which had been or should be obtained by him in the Empire of *Germany.*

The *German Company* issued a prospectus in which it was stated that the company was formed for the purpose of purchasing and working *Henley's* German patent at *Frankfort,* to manufacture a partial substitute for coffee from the date fruit. On the prospectus was printed what professed to be a copy of the articles of association, in which the first object of the company was stated to be "to acquire, and purchase, and to use, exercise, and vend certain inventions for manufacturing from dates a substitute for coffee, for which a patent has been granted by the Empire of *Germany* to *T.F. Hanley"*, &c.

At the time when the company was formed *Henley* had applied for a patent in the Empire of *Germany* for his inventions, but such patent was never granted.

In consequence of this misrepresentation some of the shareholders surrendered their shares, amounting in number to about 27,000, and withdrew from the company.

On the 12th of October, 1881, another agreement was entered into between the *German Company* and the *Date Coffee Company,* by which, after reciting that the German patent had been refused, but that the company were presenting an appeal from such refusal, the agreement of the 16th of February, 1881, was varied by the *Date Coffee Company* agreeing to grant to the *German Company,* in addition to the German patent, if obtained, the right to use the inventions patented by the English patent in *Germany,* and also to assign to them their Swedish patent in the same inventions; and it was agreed that on the completion of such grant and assignment the £50,000 payable under the former agreement should become payable either in cash or shares, at the option of the *Date Coffee Company.*

This agreement was brought before a meeting of the shareholders on the 13th of October, and was sanctioned by a majority representing 8979 shares against 2075.

Two actions by dissentient shareholders were brought to restrain the company from carrying the agreement into effect, which were still pending.

The *German Company* had expended £3000 on a manufactory at *Hamburg,* and it was stated that they were carrying on a very profitable business there in making coffee from dates, though without any German patent.

The appeal against the refusal of the German patent was unsuccessful.

On the 30th of January, 1882, this petition was presented by two shareholders, one of whom was the holder of 100 shares and the other of 10 shares, praying for the winding-up of the company on the ground that its objects had entirely failed.

The company, in opposition to the petition, produced an affidavit by Mr. *Gardiner,* a patent agent, that the application for a patent in *Germany* had been renewed on the 21st of September, but did not state what the result of the application was.

The object for which this company was formed was for working a patent in *Germany,* which was to be obtained to manufacture coffee from dates. That was the main object or substratum for which the shareholders subscribed their money, and the German patent cannot be procured. They never joined the company for the purpose of manufacturing date coffee without a patent. This brings our case within *Baring* v. *Dix,* 1 Cox, 213, where it was no longer possible to carry on the business for which the partnership was formed. In ***In re Suburaban Hotel Company*** [Law Rep. 2 Ch. 737, 750], Lord *Cairns* said, "If it were shown to the Court that the whole substratum of the partnership, the whole of the business which the company was incorporated to carry on has become impossible, I apprehend that the Court might, either under the Act of Parliament or on general principles, order the company to be wound up." This company ought, therefore, to be wound up, notwithstanding that a majority of the shareholders may be in favour of continuing the company. At the meeting of shareholders the intention there expressed was to carry on the company for the sale of the article to be manufactured without a patent, and to work a patent obtained in *Denmark,* but those objects are not within the powers of this company.

We are carrying on the business of the company within the scope of the agreement, and with the approbation of a very large majority of the shareholders. The company is empowered to work certain inventions for manufacturing coffee from dates in *Germany,* and this we may do without obtaining a patent in *Germany.* Then we are empowered "to make and use the inventions or improvements or modifications thereof", and further to manufacture and sell the preparations, and to acquire and use, exercise, and vend any other inventions for the above-mentioned or any other cognate purposes, and to import all descriptions of produce for the purpose of food, and export the same respectively. And we have power to purchase land and buildings in connection with the objects of the company. So that in fact there are many objects which we may invest the money upon, without carrying out to the full extent all the purposes for which the company was formed. The case of ***In re Langham Skating Rink Company*** [5 ChD 669], is an authority in our favour, where a winding-up order was refused on the ground that the company intended to carry out a small portion only of the original object for which it was formed. ***In re Middlesborough Assembly Rooms Company*** [14 ChD 104, 109], also supports this view. There the company proposed to carry out only a part of the original object, and four-fifths of the shareholders opposed a winding-up, and Lord Justice *James* said: “We ought not to disregard the wishes of so large a majority unless we see in their conduct something unreasonable, something like tyranny, something amounting to an

injury of which the minority have a right to complain." At the meeting held by this company shareholders representing 8979 shares supported the resolution to continue the business, while the minority represented only 2075 shares. The company had not been established a year before the petition was presented, and the Act contemplates that the company should have a year to perfect their arrangements.

KAY J. – In this case the petition is presented by two shareholders of the company, one of whom holds 100 shares and the other ten, for a winding-up of the company, and it is supported by a sufficient number of shareholders to make me quite sure that the application is a thoroughly *bonafide* one. On the other hand, it is opposed by the company and by a considerable body of shareholders. It does not appear that the company has passed any special resolution to wind up, but the clause upon which the application is made is the 5th sub-section of sect. 79, which is worded thus: "Whenever the Court is of opinion that it is just and equitable that the company should be wound up."

About the law which I have to apply to this case there really can now be no kind of doubt. Long ago, in the case of ***Baring* v. *Dix*** [1 Cox, 213], the Court decided it would dissolve a partnership where it appeared that the business could not be carried on according to the true intent of the partnership articles, although one partner objected. In that case the partnership had been instituted for spinning cotton under a patent. The patent existed, but after several attempts the invention wholly failed, and was entirely given up. One of the partners declined to assent to the dissolution, whereupon an inquiry was directed whether the co-partnership business could be carried on according to the true intent and meaning of the articles of co-partnership. He refers to the case of ***Baring* v. *Dix*** with approbation, and he says Law REp. 2 Ch. 744: "Now if I may venture to say so, I entirely concur with the course which was there taken. That was a case which manifestly required the interposition of the Court. Two persons had agreed not to manufacture cotton generally, but to join in working under a particular patent. The sole object was to work under a patent supposed to be valid at the time that the partnership was entered into. It turned out to be wholly invalid, and wholly useless. There was therefore a complete destruction of the subject matter on which the partnership was to operate. If the Court were satisfied that was the fact, I apprehend that it would be entirely competent to the Court to dissolve the partnership against the will either of the majority, or, as the case there was, of one of two partners." Then he refers to certain other cases, and finally at page 750 he says this: "It is not necessary now to decide it, but if it were shown to the Court that the whole substratum of the partnership, the whole of the business which the company was incorporated to carry on has become impossible, I apprehend that the Court might, either under the Act of Parliament or on general principles, order the company to be wound up. But what I an prepared to hold is this, that this Court, and the winding-up process of the Court, cannot be used, and ought not to be used, as the means of evoking a judicial decision as to the probable success or non-success of a company as a commercial speculation."

There came later before the Court of Appeal another case which was decided upon the same principle, the ***Haven Gold Mining Company***. By the memorandum of association of that company it was stated that the objects for which the company was established were to

purchase, hire, lease, and otherwise acquire mines and minerals, property, lands, or hereditaments in *New Zealand,* or elsewhere, or any estate, interests, rights, or privileges over any such mines which may be deemed necessary or advisable for the purposes of the company, and more particularly to carry out an agreement of the 24th of December, 1880, between *Hance* of the one part, and a trustee for the company of the other part; then to hire machinery to work and maintain the works of the company, to erect or hire smelting works, and to purchase ores from other persons, and other mines and mining companies, and to manufacture, smelt and dress such ores, minerals, and produce, to subscribe to any undertaking, offering facilities for the purpose of the company, to hold shares in companies, to acquire patent rights, to lend money on deposit, and so on. The terms of the memorandum were, "To purchase, hire, lease, or otherwise acquire mines and mineral properties, lands, and hereditaments in *New Zealand* or elsewhere", and in particular to carry out a certain agreement. It turned out that the so-called agreement was utterly valueless, being an agreement to hand over a concession which in point of fact was no concession; and the Court of Appeal determined in that case, where the objects of the company were far wider than they are here, that as the agreement entirely failed, and the company was not in fact, as I gather, carrying on or attempting to carry on any other business, but was trying to better their original concession, and so to acquire the mine which the agreement really did not give them, that practically the whole substratum of that company had failed, and following entirely (as I understand their judgment) Lord Cairns' *dictum* in the ***Suburban Hotel Company*** case [Law Rep. 2 Ch. 737], they considered that the substratum had in fact completely failed, and the company ought to be wound up; and the Master of the Rolls in his judgment says: "I have not forgotten there are general words in the memorandum of association extending the right to work mineral property generally, but the object of the company, or the special object in the memorandum of association, is to work this gold mine, and the point we have to consider is whether there is any mine at all as to which the company has a title, or a contract which may eventuate in a title." Then he says later on that he thinks there was no title, and he says: "Well, then, is it to be tolerated that the majority of the shareholders shall bind the minority to go on when they have no title at all, merely because they think it possible they may get a title?" And then he refers to instructions given to the person who was to negotiate, and says: "At present there is no negotiation and no reasonable prospect of obtaining the mine from any one."

Therefore the law so far is established thus, that if the whole substratum of the company is gone, it is within sect. 79 "just and equitable" that the company should be wound up. But then on the other side of the line comes the ***Langham Skating Rink Company,*** and that case shows where the line is to be drawn. There the object of the company was the construction or adaptation of any building or premises as a skating, rink, club, house, or place of public or private entertainment, and there was no special agreement mentioned in the memorandum, and no particular property pointed at, but there was afterwards by a prospectus a statement that a site had been purchased facing the *Langham Hotel,* and that when the block was pulled down a rink would be erected upon it. That scheme failed, and the company determined to do something much less than their original scheme; namely, to build, not the original rink, but a small rink upon a portion of the premises which they had acquired, and which could be done at less cost, and the shareholders applied to have the company wound up. In that case the

company were actually doing that which the memorandum contemplated, there was no ground for saying that the main purpose contemplated by the memorandum had failed at all. The attempt there was to make out that the main purpose – the whole substratum of the company – had failed. That argument did not succeed, because what the company were doing was strictly in every sense of the word in conformity with the memorandum, and although it was a less thing than they intended to do originally, as the prospectus showed, still the question, whether it was to be done or not, was precisely one of those questions on which the majority of the company had a right to bind the minority. I think that shows very plainly where the line is to be drawn, and I take the line to be this, that where on the face of the memorandum you see there is a distinct purpose which is the foundation of the company, then, although the memorandum may contain other general words which include the doing of other objects, those general words must be read as being ancillary to that which the memorandum shows to be the main purpose, and if the main purpose fails and fails altogether, then, within the language of Lord *Cairns* in the ***Suburban Hotel Company*** case [Law Rep. 2 Ch. 737] and within the decision of ***Baring* v. *Dix*** [1 Cox, 213], the substratum of the association fails.

With that understanding of the law I come to the question which I have to decide here, which is a question so near the line that it is a little troublesome to decide upon which side of the line it comes. In this case the name of the company is the *German Date Coffee Company, Limited,* and the name seems to me to be rather material in determining what the real object and purpose of the company was. The memorandum stated the objects of the company to be "to acquire and purchase, and to use, exercise, and vend certain inventions for manufacturing from dates a substitue for coffee, for which a patent has or will be granted by the Empire of *Germany."* I pause there, because it has been said that may be read in two ways–that you may read the first part as meaning to acquire an invention, and the rest of it as a merely incidental statement that a patent will be granted. Of course the observation occurs at once that it is one thing for the company to work in *Germany* a German patent, and a very different thing to form a company to work in *Germany* an invention for which there is no patent, and I have no doubt whatever that this first clause of the memorandum means to acquire and purchase a patented invention, an invention for which a patent has been or will be granted. Reading the whole of that clause together, I have no doubt at all it means to purchase and work an invention patented in *Germany.* The other words also seem to me to confirm that meaning, because the same clause goes on, "and also to acquire and purchase any other patents or privileges which may be granted to *Henley* by the Empire of *Germany"*; so that I read the first clause as being a clause which makes at any rate the first object of the company the acquisition and working of an invention patented in *Germany.* Then the second is this, "to make and use the said inventions." What are the said inventions? They are the inventions patented in *Germany,* or improvements thereon, or modifications thereof. It is said, if I read the second clause as meaning patented inventions, it is tautologous and useless. I admit there is a certain amount of tautology, but it is not entirely useless, because there is a sufficient purpose for the second clause in those words, "or any improvement therein or modification thereof" and I think that is the meaning. I should be slow to say that this second clause means to make and use the said inventions, whether patented or not, which is the construction it is argued I ought to adopt, because it would be very easy if that was the meaning to say so in

unmistakable words, and without plainer words I do not think myself at liberty to consider the clause as meaning to use the said inventions whether they are patented or not. Then what follows in the third clause is, "to adopt and carry out a certain agreement", which is described, and to which I will refer presently. The fourth is, "to manufacture and sell the preparations which are the subject of the said inventions, or any or either of them." That *prima facie* means to manufacture and sell the preparations which are the subject of the patented invention. I think that ambiguity, if ambiguity there is, is removed by the fifth clause, which clause is to this effect: "to grant licenses for the manufacture of the said preparations": clearly shewing that the draughtsman, by "preparations", meant preparations made under the patent. The sixth is, "to apply for and obtain patents for improvements in or extensions of the said inventions, or any modification thereof, or any matters in any way incidental thereto." The seventh is, "to acquire, by purchase or otherwise, and to use, exercise, and vend any other inventions for the above-mentioned or cognate purposes." Then the eighth is, "to import all descriptions of produce for the purposes of food, and the exporting of the same respectively from such countries and the selling and disposing thereof, and to acquire and obtain by purchase, or to lease or hire, and so on, any land and buildings, &c., in connection with the above-mentioned purposes, for the purposes of the company or any company in the formation of which this company may have an interest." Then, to sell, lease, or otherwise dispose or mortgage the patent rights, lands, premises, &c., of the company, and to invest the capital of the company in building on these lands, and so on. As no stress has been laid upon any of the subsequent clauses of the memorandum, I need not read them further.

I cannot really doubt that the meaning of this memorandum is that the first purpose, the main object of the company, is to acquire an invention patented in *Germany,* and to work that invention, and that it is not to acquire an invention which is not patented, and if I had any doubt I am at liberty to look to the agreement mentioned in the memorandum in order to clear up that doubt, and when I look to the agreement, I find it was made the same day the company was formed, and is between another company, an English company, which had been formed to work an English patent for the same invention, and one *Hiller,* as trustee for what is called the *German Date Coffee Company.* After reciting that *Henley* had applied for a German patent, the agreement witnesses "that *Hillier* shall purchase from the *English Date Coffee Company* the said letters patent in and for the Empire of *Germany,* and also all improvements, if any, which may be thereafter made or discovered therein, or additions thereto, and the benefit of any further letters patent which may be obtained for such improvement, and any extensions thereof" and the consideration for the said purchase was to be £ 50,000. There is nothing in this agreement I believe which gives to the *German Date Coffee Company* anything in the nature of license or power to work this invention, supposing the *English Company* could give such a right without a patent in *Germany.* The whole thing contemplates the assignment for £ 50,000 to the *German Date Coffee Company* of a patent procured or to be procured in *Germany* for a particular invention, and any subsequent patent that might be obtained for improvements in *Germany.* Looking at that, I cannot doubt for one moment what the meaning of this memorandum was. They had no agreement whatever to work any invention in *Germany* except the German patent. That was the thing which was comprised in the agreement mentioned in that memorandum. Afterwards there were attempts made to get the patent in *Germany,* which did not succeed. There can be no doubt now, if ever there was

any doubt, since the judgment in the case of the ***Ashbury Railway Carriage Company* v. *Riche*** [Law Rep. 7 H.L. 653], what is the effect of the memorandum of a joint-stock company. Lord Cairns, in his judgment in that case, to which we have so often had to refer, says this, Law Rep. 7 H.L. 607: "With regard to the memorandum of association, your Lordships will find, as has often already been pointed out, although it appears somewhat to have been overlooked in the present case, that that is as it were the charter, and defines the limitation of the powers of a company to be established under the Act. With regard to the articles of association, those articles play a part subsidiary to the memorandum of association"

Therefore I must look to the memorandum and the memorandum only, to know what is the charter of the *German Date Coffee Company,* and what are the objects and purposes of its formation.

Passing on from the first agreement it seems that other agreements from time to time were made, and I notice incidentally, not in the least as influencing the conclusion to which I come, but for the purpose of giving a narrative of what took place, that a prospectus was issued in February, 1881, which began by stating, "The company if formed for the purpose of purchasing and working *Henley's* German patent at *Frankfort,* to manufacture a partial substitute for coffee from the date fruit" and the prospectus had printed upon it what was alleged to be a copy of the memorandum of association of the *German Company,* but instead of stating the first object in the terms of the memorandum, it stated the object to be "to acquire and purchase and to use, exercise, and vend certain inventions for manufacturing from dates a substitute for coffee, for which a patent has been granted by the Empire of *Germany."* It seems because that statement was not true many shareholders applied to be relieved from their contracts as shareholders, and the company felt themselves bound to accept the surrender of a great number of shares. After that, as there was some difficulty in obtaining a patent from *Germany,* modifications of the agreement were made, one dated the 13th of May, 1881, which I need not dwell upon, when they contemplated that letters patent would be eventually granted by the Empire of *Germany,* and another agreement, which I must refer to. It seems by that agreement, dated the 12th of October, 1881, which was made between the *English Company* of the one part, and the *German Company* of the other part, after reciting what had taken place and the efforts to obtain a patent in *Germany,* it was agreed between the parties that the *English Company* should grant to the *German Company* "the sole use and exclusive license, power, and authority, so far as they can grant the same, to make, use, manufacture, sell, lease, license, or let, in and for the Empire of *Germany* all the inventions patented for and in the Kingdom of *Great Britain* and *Ireland.*" What power had the *English Company* to grant the English patent to be used in *Germany?* The English patent gives them no exclusive right to use the invention in *Germany,* and without any such attempted license the *German Company* might have used the invention in *Germany* as much as they liked. Then it went on: "The company shall if and when the result of the appeal against the refusal to grant such letters patent shall ultimately be successful, and the said letters patent be granted and issued to the company, forthwith duly assign and make over the same to the *German Company."* Then it provides that the company shall duly assign to the *German Company* all or any patents now or hereafter to be applied for without any payment whatever, and then that they would assign to the *German Company* at once the Swedish patent and all rights possessed or enjoyed by them by reason of the possession or ownership of such Swedish patent, and that the *German*

Company should upon the execution of the grant mentioned in clause 1 (which, so far as I understand, was a perfectly nugatory grant and the assignment mentioned in clause 4 (which was the assignment of the Swedish patent), for the same invention pay the sum of £50,000. That agreement it seems was brought before a meeting of the shareholders, and at that meeting sanction was obtained to the agreement upon the 13th of October. There were 8979 votes for adopting the agreement and 2075 against it, and it bound the company to pay £50,000 for a perfectly nugatory grant of a license to use an English patent in *Germany,* and for the assignment of a Swedish patent which would be of no more use in *Germany* than an English patent. Two actions were brought to restrain the company from entering upon the agreement, and the company, upon an interlocutory motion, undertook not to carry out any part of that agreement.

What remains is this. It is said the company have works in *Hamburg,* which they acquired when they hoped to obtain the German patent, and that there they are carrying on some manufacture of date coffee, but of course not under a German patent, because they have not got the German patent. I must add to the narrative which I have given up to this point, that the hope of getting the German patent seems to be very small, because the appeal against the determination not to grant it has been tried and has failed, and I do not know that there is any further appeal possible. Therefore I must take it upon these materials that it is entirely out of the question that any German patent can be obtained.

Now the question is under which class of authorities does this case come. Does it come under the class of which the *Langham Skating Rink* is an example, or under the class of which the *Suburban Hotel* and the *Haven Gold Mining Company* are examples? I must answer that by these considerations. Here it is beyond all question that the German patent is not, and I must take it now cannot be obtained. Certainly, according to the memorandum of association of this company, the acquisition of a German patent and working under it was the main and principal object of the existence of this *German Date Coffee Company.* Any other thing in the memorandum, if there by any, seems to be subsidiary and auxiliary only to that object of working a German patent. Therefore it seems to me that the case comes within the ***Suburban Hotel Company's*** case, Law Rep. 2 Ch. 737, and the ***Haven Gold Mining*** case, *Ante,* p. 151, rather than that of the ***Langham Skating Rink****,* 5 Ch. D. 669, and that this is a case in which that which is, or rather was to be, the substratum, the main object of the company, to which all other objects are merely subsidiary and auxiliary, namely, the obtaining of a German patent for a particular invention, has completely failed. Therefore it seems to me that it is a case in which it would be beyond the purposes of this company to carry on the business which they now propose to carry on, and that I ought to regard the wish of the minority, who say we decline to be involved in the carrying on of a business which was really not contemplated by the memorandum of association at all.

But then it is said another patent has been obtained, namely, the Swedish patent. It seems almost ludicrous to imagine that the German Company*,* a company formed for the purpose of carrying on business in Germany*,* can say that it has taken any steps towards the accomplishment of that object by obtaining a Swedish patent for the same invention. I look to the memorandum of association again, and the only clause under which it is pretended to justify that acquisition of the Swedish patent, which is only obtained, if at all, under the

agreement of the 12th of October, 1881, is the 7th clause, and the 7th clause is this: "To acquire by purchaser or otherwise, and to use, exercise, and vend any other inventions for the above-mentioned or cognate purposes." The Swedish patent is not another invention but it is another patent for the same invention in another country, and I think it would be entirely *ultra vires* to acquire the Swedish patent.

The absurdity of giving £ 50,000 for a Swedish patent and for a license under the English patent to enable the *German Company* to make coffee in *Germany* is too glaring to need any comment at all.

I therefore think the whole substratum of the company has failed, and that the authorities I have referred to are sufficient not only to authorize but to oblige the Court to put a stop to the further proceedings of this company, which will, in my opinion, be neither more nor less than employing moneys obtained from the shareholders, in carrying on a business which practically is not authorized by the memorandum of association. I therefore make the usual winding-up order. No order as to costs, except that the company will take their costs.

ESSEL, M.R. – This company, in my opinion, was formed, as the directors stated in their prospectus, for the purpose of purchasing and working Henley's German patent at *Frankfort,* for the manufacture of a partial substitute for coffee from the date fruit. Of course, I do not use the prospectus for the purpose of interpreting the memorandum of association, I only use it for the purpose of showing that my construction is probably correct, because it is the construction adopted by the chairman and directors of the company after its incorporation, and before they issued the prospectus inviting the public to come in. It is the duty of the Court in construing a document, to read it and to ascertain its meaning fairly from the contents of it, but it is always a satisfaction to me when I find my construction of a contract is that which is adopted by every party to it.

The company is stated to be registered for several objects. The first object is to acquire a German patent granted to one *Henley* for manufacturing from dates a substitute for coffee. The second is to make and use the same invention or any improvement of it. That refers to the German patent. The memorandum is tautologous, an observation which need not be confined to this memorandum–it is very common as regards all memorandum of association. The third object is to adopt and carry out an agreement dated the 16th of February, 1881. When we come to look at that, it is an agreement for the sale of the German patent. Article 4 is to manufacture and sell the preparations which are the subject of the said invention. That is pure tautology. Nobody has been able to suggest that there is anything there which is not included in Articles 1 and 2. Article 5 is to grant licenses. Of course, if you have no patent you cannot grant licenses. Article 6 is to apply for and obtain patents for improvements or extensions of the said invention, and so on. Article 7 is to acquire and purchase, or otherwise to use, exercise, and vend, any other inventions for the above-mentioned or cognate subject. All those are merely ancillary provisions. Then there is Article 8, which I read to be this, to import all descriptions of produce, in connection with the above-mentioned purpose, or otherwise for the purposes of the company. It never can mean to import and export food produce generally. That would be making it a company for an entirely new and distinct purpose. The other reading is, in my opinion, the more grammatical reading of the two; but

whether it is so or not, it is, I think, the correct reading, and is merely ancillary. That being so, it appears to me that this memorandum, when fairly read, and notwithstanding the rather loose use of general words, is simply to buy this patent, and to work it either with or without improvements. That is the substance of the whole thing.

Now what happened was this. I have no reason to doubt that the framers of the memorandum and articles believed that they would obtain the German patent, for they said, "for which a patent has or will be granted by the Empire of *Germany.*" But they were a little too sanguine, and they cannot complain if, like other prophets, their prophecies are sometimes not verified by the result. It turned out that the German Empire would not grant the patent. When that happened what ought they to have done? Surely they ought to have said, "We cannot carry on business, and we must wind up"; and that is exactly what Mr. Justice *Kay* ordered to be done. There is an interim matter which ought not to be forgotten. A large number, in fact the majority of the applicants for shares, had their names taken off on the ground of deception. They understood there was a patent when there was not, and the number of shareholders left is very small–holding something like 13,000 shares in all–a very different company from the original company, which was formed with 100,000 shares. Then it turns out that the company has, quite *bonafide,* in anticipation of the granting of the German patent, established at *Hamburg* a factory for the manufacture of this substance called date coffee, and they say they have sold a good deal of it and are doing a prosperous trade. They have also entered into an agreement with the parent company, and English company called the Date Coffee Company, by which that company has agreed not to compete with this company in *Germany.* I ought also to refer to the affidavit of Mr. Gardiner*,* who says that he applied in September for a patent on behalf of Mr. *Hanley,* but he does not say that he obtained it, and I therefore assume that for some reason or other it was refused. This application, whatever the result may have been, appears to me no ground for varying the order which has been made. That being so, it seems to me, as the learned Judge of the Court below said, the whole substratum of the company is gone. Its business was not to make a substitute for coffee from dates, but to work a German patented invention in *Germany*; to work it under the monopoly granted by the German Government to the patentee, and not to enter into any such business generally. Therefore the shareholders have a right to say, and the minority of the shareholders have a right to say, "We did not enter into partnership on the terms." It is exactly like ***Baring* v. *Dix***, 1 Cox, 213. It was not a general partnership to make a substitute for coffee from dates, but to work a particular patent, and as that particular patent does not exist, and cannot now exist, they are entitled to say the company ought to be wound up.

BAGGALLAY, L.J. – I am of the same opinion. It appears to me that the principle involved in the decision of ***In re Suburban Hotel Company*** [Law Rep. 2 Ch. 737, 742], by Lord Cairns amounts to this, that if you have proof of the impossibility of carrying on the business contemplated by the company at the time of its formation, that is a sufficient ground for winding up the company. Therefore the question arises in the present case, is there an impossibility of carrying out the objects of the company? I cannot entertain any doubt, having regard to the memorandum of association, and the view I take of the memorandum is verified by the surrounding circumstances, that the real contemplated object of the company at the time when it was formed was to carry out the manufacture of German date coffee, to be

manufactured from dates, to be manufactured in *Germany* under a patent that was actually granted or about to be granted, and that in the contemplation of all parties the granting of the letters patent in *Germany* for the working of this invention was the basis of the company. No doubt in this case, as in many other cases, you have a variety of general words added which, if they are to be construed by themselves, would give powers to carry on almost any possible business which could be suggested. There must be taken within certain limits, and those limits are, that they must be regarded as ancillary to the purport of the scheme for which the company was formed. It appears to me, for the memorandum of association so construed, that the business of the company was the manufacturing of coffee by virtue of a patent already obtained, or to be obtained, with the benefit of any improvement that might be made by the patentee or the company in connection with that patent.

Now, is there an utter impossibility in carrying on the business of the company? It appears to me from the evidence that there is. Not only is there very strong evidence that the obtaining of these letters patent was contemplated by all the parties who took shares, but the holders of 27,000 shares, being more than one quarter of all the shares in the company, had their names removed from the register of shareholders, on the ground that they had been deceived by a statement in the prospectus that the patent had been already obtained.

It appears to me beyond all question that there is an impossibility of carrying on the business of the company, and I think that the order Mr. Justice *Kay* made is quite correct. I feel bound to say I entirely go with him in the enunciation of the law applicable to the case, and his criticisms on the cases.

LINDLEY, L.J. – I am of the same opinion. The first question we have to consider is, what is the fair construction of the memorandum of association? It is required by the Act of 1862 to state what the objects of the company are. In construing this memorandum of association, or any other memorandum of association in which there are general words, care must be taken to construe those general words so as not to make them a trap for unwary people. General words construed literally may mean anything; but they must be taken in connection with what are shown by the context to be the dominant or main objects. It will not do under general words to turn a company for manufacturing one thing into a company for importing something else, however general the words are. Taking that as the governing principle, it appears to me plain beyond all reasonable dispute that the real object of this company, which, by the by, is called the German Date Coffee Company, Limited, was to manufacture a substitute for coffee in *Germany* under a patent, valid according to German law. It is what the company was formed for, and all the rest is subordinate to that. The words are general, but that is the thing for which the people subscribe their money.

Now, I attach great importance to an observation made by Mr. Buckley, that the petitioners did not wait for a year after the formation of the company before presenting their petition. It was presented within a year, and therefore we ought to be careful in considering what ought to be done under those circumstances, because the Act of Parliament gives the company a year to see whether it can get to work or not. The language of the 79th section, sub-s. 2, is, "Whenever the company does not commence its business within a year from its incorporation, or suspends business for the space of a year." That, I understand, is to give the

company a reasonable time. Supposing that there was no proof that the company had failed within a year, I should think that the company was entitled by statute to a year–the shareholders would be entitled to it. But when we have to deal with a case in which it is apparent within a year that the whole thing is abortive, that the company cannot acquire that which it was intended to acquire, and cannot carry out the objects for which it was formed, the Act of Parliament does not require us to wait a year, and the case is then brought fairly within the 5th clause of the same sub-section, *i.e.,* whenever the Court is of opinion that it is "just and equitable" that the company should be wound up.

I proceed, therefore, to the next point, whether the petition having been presented within the year the evidence shows that the objects for which the company was formed cannot be attained. To my mind the evidence is overwhelming. The company have tried to get this patent and have failed, and the only point which appears to me to present any difficulty is that last thrown out by Mr. *Ince,* and very properly insisted on by him and Mr. *Buckley,* that there is even now an application to the Government for a patent. I have looked at that a little closely, and my opinion is there is nothing in it at all. Mr. *Gardiner* makes an exhibit of a document from the German Patent Office; I have looked at it, and all it comes to is this–it is a certificate that an application had been made to the Imperial Patent Office on behalf of Mr. Henley, of London, for a patent for an apparatus for drying and roasting dates; that is what is applied for. That was the 21st of September, and we are told that in the absence of opposition a patent would be got in two months. That would be the 21st of November, and this affidavit is sworn the 4th of February, 1882, and there is still not patent. What does such an affidavit mean? It is a mere blind; it is put on the file to throw dust in the eyes of the Court.

It appears to me, therefore, that the judgment of Mr. Justice Kay was perfectly correct, and that the facts warrant the judgment he pronounced, and the application ought to be dismissed with costs.

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Seth Mohan Lal v. *Grain Chambers, Muzaffarnagar*

AIR 1968 SC 772

J.C. SHAH, J. – The Grain Chamber Ltd., Muzaffarnagar, a Company registered under the Indian Companies Act, 1913 was framed for the purpose of carrying on business of an exchange in grains, Cotton, sugar, *gur*, pulses and other commodities. In the years 1949 and 1950 the Company was carrying on business principally in "futures" in *gur*.

On March 14, 1949, the Board of Directors of the Company passed a resolution sanctioning transaction of business in "futures" in *gur* for Phagun Sudi 15 Samvat 2006 (March 4, 1950) settlement. On August 9, 1949, Seth Mohan Lal and Company purchased one share of the Company and qualified for membership. They commenced dealing with the Company in "futures" in *gur*. By December 1949 Seth Mohan Lal and Company – who will hereinafter be called 'the appellants' – had entered into transactions with the Company which aggregated to 1136 Bijaks of sale of *gur* for the Paush Sudi 15, 2006 delivery. The appellants also claimed that they had entered into sale transactions in 2137 Bijaks in the benami names of five other members. In January 1950 there were large fluctuations in the prices of *gur*, and in order to stabilise the prices, the directors of the Company passed a resolution in a meeting held on January 7, 1950, declaring that the Company will not accept any settlement of transaction in excess of Rs. 17-8-0 per maund. The sellers were required to deposit margin money between the prices prevailing on that date and the maximum rate fixed by the Company. The appellants deposited in respect of their transactions Rs. 5,26,996-14-0 as margin money. They claimed also to have deposited amounts totalling Rs. 7 lakhs odd in respect of their benami transactions.

In exercise of the powers conferred by Section 3 of the Essential Supplies (Temporary Powers) Act 24 of 1946, the Government of India issued a notification on February 15, 1950, amending the Sugar (Futures and Options) Prohibition Order, 1949, and made it applicable to "futures" and options in *gur*. By that Order entry into transactions in "futures" after the appointed day was prohibited. On the same day the Board of Directors of the Company held a meeting and resolved that the rates of *gur* which prevailed at the close of the market on February 14, 1950, viz., Rs. 17-6-0 per maund be fixed for settlement of the contracts of Phagun delivery. It was recited in the resolution that five persons including Lala Mohan Lal, partner of the appellants, were present at the meeting on special invitation. In Clause 2 of the resolution it was recited that as the Government had banned all forward contracts in *gur* it was resolved to take the prevailing market rate on the closing day of February 14, 1950, which was Rupees 17-6-0 per maund for Phagun delivery and to have all outstanding transactions of Phagun delivery settled at that rate.

Entries were posted in the books of account of the Company on the footing that all outstanding transactions in futures in *gur* were settled on February 15, 1950. In the account of Mohan Lal and Company an amount of Rs. 5,26,996-14-0 which stood to the credit of the appellants. Against that amount Rs. 5,15,769-5-0 were debited as "loss adjusted," and on February 15, 1950, an amount of Rs. 11,227-9-0 stood to their credit. Similar entries were posted in the accounts of other persons who had outstanding transactions in *gur*.

On February 22, 1950, the appellants and their partner Mohan Lal filed a petition in the High Court of Judicature at Allahabad for an order winding up of the Company. Diverse grounds were set up in the petition. The principal grounds were that the Company was unable to pay its debts, that it was just and equitable to wind up the Company, because the directors and the officers of the Company were guilty of fraudulent acts resulting in misappropriation of large funds, and that the substratum of the Company had disappeared, the business of the Company having been completely destroyed.

Brij Mohan Lal, J., held that the Company was not unable to pay its debts and that it was not just and equitable to wind up the Company on the grounds set out in the petition. Orders passed by Brij Mohan Lal, J., dismissing the petitions were confirmed by the High Court of Allahabad in its appellate jurisdiction. With certificates granted by the High Court, these two appeals have been preferred by the appellants and their partner Mohan Lal.

The High Court held that by the notification dated February 15, 1950 the outstanding transactions of "futures" in *gur* did not become void; that in fixing the rate of settlement by resolution dated February 15, 1950, and settling the transactions with the other contracting parties at that rate the directors acted prudently and in the interests of the Company and of the shareholders, and in making payments to the parties on the basis of a settlement at the rate the directors did not commit any fraudulent act or misapply the funds of the Company that the case of the appellants that apart from the transactions entered into by them in their firm name, they had entered into other transactions benami in the names of other firms, and that the Company had malafide settled those transactions with those other firms were not proved; and that the Board of Directors was and remained properly constituted at all material times and no provision of the Company Act was violated by the directors trading with the Company.

Finally, it was urged that by reason of the notification issued by the Central Government, the substratum of the Company was destroyed and no business could be carried on by the Company thereafter. It was said that all the liquid assets of the Company were disposed of and there was no reasonable propsect of the Company commencing or carrying on business thereafter.

The Company was carrying on extensive business in "futures" in *gur*, but the Company was formed not with the object of carrying on business in "futures" in *gur* alone, but in several other commodities as well. The Company had immovable property and liquid assets of the total value of Rs. 2,54,000. There is no evidence that the Company was unable to pay its debts. Under S. 162 of the Indian Companies Act, the Court may make an order for winding up a Company if the Court is of the opinion that it is just and equitable that the Company be wound up. In making an order for winding up on the ground that it is just and equitable that a Company should be wound up, the Court will consider the interests of the shareholders as well as of the creditors. Substratum of the Company is said to have disappeared when the object for which it was incorporated has substantially failed, or when it is impossible to carry on the business of the Company except at a loss, or the existing and possible assets are insufficient to meet the existing liabilities. In the present case the object for which the Company was incorporated has not substantially failed, and it cannot be said that the Company could not carry on its business except at a loss, nor that its assets were insufficient to meet its liabilities. On the view we have taken, there were no creditors to whom

debts were payable by the Company. The appellants had, it is true, filed suits against the Company in respect of certain *gur* transactions on the footing that they had entered into transactions in the names of other persons. But those suits were dismissed. The business organisation of the Company cannot be said to have been destroyed, merely because the brokers who were acting as mediators in carringout the business between the members had been discharged and their accounts settled. The services of the brokers could again be secured. The Company could always restart the business with the assets it possessed, and prosecute the objects for which it was incorporated. It is true that because of this long drawn out litigation, the Company's business has come to a standstill. But we cannot on that ground direct that the Company be wound up. Primarily, the circumstances existing as at the date of the petition must be taken into consideration for determining whether a case is made out for holding that it is just and equitable that the Company should be wound up, and we agree with the High Court that no such case is made out. The appeals fail and are dismissed.

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Adjudicatory Bodies

Madras Bar Association Vs Union of India & Anr.

Writ Petition (C) No. 1072 Of 2013

A.K. SIKRI, J.

This writ petition filed by the petitioner, namely, the Madras Bar Association, is sequel to the earlier proceedings which culminated in the judgment rendered by the Constitution Bench of this Court in Union of India v. R. Gandhi, President, Madras Bar Association (hereinafter referred to as the '2010 judgment'). In the earlier round of litigation, the petitioner had challenged the constitutional validity of creation of National Company Law Tribunal ('NCLT' for short) and National Company Law Appellate Tribunal ('NCLAT' for short), along with certain other provisions pertaining thereto which were incorporated by the Legislature in Parts 1B and 1C of the Companies Act, 1956 (hereinafter referred to as the 'Act, 1956') by Companies (Second Amendment) Act, 2002.

2) Writ petition, in this behalf, was filed by the petitioner in the High Court of Madras which culminated into the judgment dated 30.03.2004. The High Court held that creation of NCLT and vesting the powers hitherto exercised by the High Court and the Company Law Board ('CLB' for short) in the said Tribunal was not unconstitutional. However, at the same time, the High Court pointed out certain defects in various provisions of Part 1B and Part 1C of the Act, 1956 and, in particular, in Sections 10FD(3)(f)(g)(h), 10FE, 10FF, 10FL(2), 10FR(3), 10FT. Declaring that those provisions as existed offended the basic Constitutional scheme of separation of powers, it was held that unless these provisions are appropriately amended by removing the defects which were also specifically spelled out, it would be unconstitutional to constitute NCLT and NCLAT to exercise the jurisdiction which is being exercised by the High Court or the CLB. The petitioner felt aggrieved by that parts of the judgment vide which establishments of NCLT and NCLAT was held to be Constitutional. On the other hand, Union of India felt dissatisfied with the other part of the judgment whereby aforesaid provisions contained in Parts 1B and 1C of the Act, 1956 were perceived as suffering from various legal and Constitutional infirmities. Thus, both Union of India as well as the petitioner filed appeals against that judgment of the Madras High Court. Those appeals were decided by the Constitution Bench, as mentioned above.

3) The Constitution Bench vide the said judgment put its stamp of approval insofar as Constitutional validity of NCLT and NCLAT is concerned. It also undertook the exercise of going through the aforesaid provisions contained in Parts 1B and 1C of the Act, 1956 and in substantial measure agreed with the Madras High Court finding various defects in these provisions. These defects were listed by the Court in para 120 of the judgment which reads as under:

"120. We may tabulate the corrections required to set right the defects in Parts I-

B and I C of the Act:
(i) Only Judges and advocates can be considered for appointment as judicial members of the Tribunal. Only High Court Judges, or Judges who have served in the rank of a District Judge for at least five years or a person who has practiced as a Lawyer for ten years can be considered for appointment as a Judicial Member. Persons who have held a
Group A or equivalent post under the Central or State Government with experience in the Indian Company Law Service (Legal Branch) and Indian Legal Service (Grade-1) cannot be considered for appointment as judicial members as provided in sub-section 2(c) and (d) of Section 10FD. The expertise in Company Law service or Indian Legal service will at best enable them to be considered for appointment as technical members.
(ii) As the NCLT takes over the functions of High Court, the members should as nearly as possible have the same position and status as High Court Judges. This can be achieved, not by giving the salary and perks of a High Court Judge to the members, but by ensuring that persons who are as nearly equal in rank, experience or competence to High Court Judges are appointed as members. Therefore, only officers who are holding the ranks of Secretaries or Additional Secretaries alone can be considered for appointment as Technical members of the National Company Law Tribunal. Clauses (c) and (d) of sub-section (2) and Clauses (a) and (b) of sub-section (3) of section 10FD which provide for persons with 15 years experience in Group A post or persons holding the post of Joint Secretary or equivalent post in Central or State Government, being qualified for appointment as Members of Tribunal is invalid.

(iii) A “technical member” presupposes an experience in the field to which the Tribunal relates. A member of the Indian Company Law Service who has worked with Accounts Branch or officers in other departments who might have incidentally dealt with some aspect of company law cannot be considered as “experts” qualified to be appointed as technical members. Therefore clauses (a) and (b) of sub-section (3) are not valid.”

(iv) A `Technical Member' presupposes an experience in the field to which the Tribunal relates. A member of Indian Company Law Service who has worked with Accounts Branch or officers in other departments who might have incidentally dealt with some aspect of Company Law cannot be considered as `experts' qualified to be appointed as Technical Members. Therefore Clauses (a) and (b) of sub-section (3) are not valid. (v) The first part of clause (f) of sub-section (3) providing that any person having special knowledge or professional experience of 15 years in science, technology, economics, banking, industry could be considered to be persons with expertise in company law, for being appointed as Technical Members in Company Law Tribunal, is invalid.

(v) Persons having ability, integrity, standing and special knowledge and

professional experience of not less than fifteen years in industrial finance, industrial management, industrial reconstruction, investment and accountancy, may however be considered as persons having expertise in rehabilitation/revival of companies and therefore, eligible for being considered for appointment as technical members.

(vi) In regard to category of persons referred in clause (g) of sub-section (3) at least five years experience should be specified.

(vii) Only clauses (c), (d), (e), (g), (h), and latter part of clause (f) in sub-section (3) of section 10-FD and officers of civil services of the rank of the Secretary or Additional Secretary in Indian Company Law Service and Indian Legal Service can be considered for purposes of appointment as technical members of the Tribunal.

(viii) Instead of a five-member Selection Committee with Chief Justice of India (or his nominee) as Chairperson and two Secretaries from the Ministry of Finance and Company Affairs and the Secretary in the Ministry of Labour and Secretary in the Ministry of Law and Justice as members mentioned in section 10FX, the Selection
Committee should broadly be on the following lines:

(a) Chief Justice of India or his nominee - Chairperson (with a casting vote);
(b) A senior Judge of the Supreme Court or Chief Justice of High Court – Member;
(c) Secretary in the Ministry of Finance and Company Affairs - Member; and
(d) Secretary in the Ministry of Law and Justice - Member.

(ix) The term of office of three years shall be changed to a term of seven or five years subject to eligibility for appointment for one more term. This is because considerable time is required to achieve expertise in the concerned field. A term of three years is very short and by the time the members achieve the required knowledge, expertise and efficiency, one term will be over. Further the said term of three years with the retirement age of 65 years is perceived as having been tailor-made for persons who have retired or shortly to retire and encourages these Tribunals to be treated as post-retirement havens. If these Tribunals are to function effectively and efficiently they should be able to attract younger members who will have a reasonable period of service.

(x) The second proviso to Section 10FE enabling the President and members to retain lien with their parent cadre/ministry/department while holding office as President or Members will not be conducive for the independence of members. Any person appointed as members should be prepared to totally disassociate himself from the Executive. The lien cannot therefore exceed a period of one

year.

(xi) To maintain independence and security in service, sub-section (3) of section 10FJ and Section 10FV should provide that suspension of the President/Chairman or member of a Tribunal can be only with the concurrence of the Chief Justice of India.

(xii) The administrative support for all Tribunals should be from the Ministry of Law & Justice. Neither the Tribunals nor its members shall seek or be provided with facilities from the respective sponsoring or parent Ministries or concerned Department.

(xiii) Two-Member Benches of the Tribunal should always have a judicial member. Whenever any larger or special benches are constituted, the number of Technical Members shall not exceed the Judicial Members."

4) On the basis of the aforesaid, partly allowing the appeals, the same were disposed of in the following terms:

"57. We therefore dispose of these appeals, partly allowing them, as follows:

(i) We uphold the decision of the High Court that the creation of National Company Law Tribunal and National Company Law Appellate Tribunal and vesting in them, the powers and jurisdiction exercised by the High Court in regard to company law matters, are not unconstitutional.

(ii) We declare that Parts 1B and 1C of the Act as presently structured, are unconstitutional for the reasons stated in the preceding para. However, Parts IB and IC of the Act, may be made operational by making suitable amendments, as indicated above, in addition to what the Union Government has already agreed in pursuance of the impugned order of the High Court."

5) Though the verdict came in the year 2010, upholding the creation of NCLT and NCLAT, these two bodies could not be created and made functional immediately thereafter and the matter got stuck in imbroglio of one kind or the other. It is not necessary to trace out those factors as some of those are the subject matter of Writ Petition No.267/2012 which writ petition is also filed by this very petitioner and is pending consideration. Said writ petition was listed before this Bench along with the present writ petition and arguments to some extent were heard in petition as well. However, since the issues raised in the said petition necessitate further response from the Union of India, with the consent of the parties, it was deemed proper to defer the hearing in that petition, awaiting the response. Insofar as the present writ petition is concerned, though somewhat connected with writ petition No.267/2012, prayers made in this writ petition are entirely different and there was no handicap or obstruction in proceeding with the hearing of the instant writ petition.
For this reason, the arguments were finally heard in this case.

6) Adverting to the present writ petition, it so happened that the Parliament has passed new company law in the form of Indian Companies Act, 2013 (hereinafter referred to as the 'Act, 2013') which replaces the earlier Act, 1956. In this Act, again substantive provisions have been made with regard to the establishment of NCLT and NCLAT. It is obvious that with the constitution of NCLT and NCLAT, the provisions relating to the structure and constitution of NCLT and NCLAT, the provisions relating to qualifications for appointment of President/Chairperson and Members (judicial as well as technical) of both NCLT and NCLAT, and also provisions relating to the constitution of the Selection Committee for selection of the said Members have also been incorporated in the Act, 2013. These are analogous to Section 10FD, 10FE, 10FF, 10FL, 10FR and 10FT which were introduced in the Act, 1956 by Companies (Amendment) Act, 2002. The cause for filing the present petition by the petitioner is the allegation of the petitioner that notwithstanding various directions given in 2010 judgment, the new provisions in the Act, 2013 are almost on the same lines as were incorporated in the Act, 1956 and, therefore, these provisions suffer from the vice of unconstitutionality as well on the application of the ratio in 2010 judgment. It is, thus, emphasized by the petitioner that these provisions which are contained in Sections 408, 409, 411(3), 412, 413, 425, 431 and 434 of the Act, 2013 are ultra vires the provisions of Article 14 of the Constitution and, therefore, warrant to be struck down as unconstitutional. The precise prayer contained in the writ petition reads as under:

> "(i) a WRIT, ORDER OR DIRECTION more particularly in the nature of WRIT OF DECLARATION declaring that the provisions of Chapter XXVII of the Companies Act, 2013, more particularly Sections 408, 409, 411(3), 412, 413, 425, 431 and 434 of the Act as ultra vires the provisions of Article 14 of the Constitution and accordingly striking down the said provisions as unconstitutional;
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> (ii) Pass any order or such further order or orders as may be deemed fit and proper in the facts and circumstances of the present case."

7) Before we proceed further, we would like to set down the aforesaid provisions of the Act, 2013 along with Section 2(4), Section 2(90) and Section 407 which contained certain definitions that are relevant in the context of controversy raised in the present petition:

> "2(4) "Appellate Tribunal" means the National Company Law Appellate Tribunal constituted under section 410;
> "2(90) "Tribunal" means the National Company Law Tribunal constituted under section 408;
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> 407. In this Chapter, unless the context otherwise requires,—
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> (a) "Chairperson" means the Chairperson of the Appellate Tribunal;
> (b) "Judicial Member" means a member of the Tribunal or the Appellate Tribunal appointed as such and includes the President or the Chairperson, as the case may be;
> (c) "Member" means a member, whether Judicial or

Technical of the Tribunal or the Appellate Tribunal and includes the President or the Chairperson, as the case may be;

(d) "President" means the President of the Tribunal;

(e) "Technical Member" means a member of the Tribunal or the Appellate Tribunal appointed as such.

408. Constitution of National Company Law Tribunal
409. Qualification of President and Members of Tribunal
410. Constitution of Appellate Tribunal
411. Qualifications of chairperson and Members of Appellate Tribunal
412. Selection of Members of Tribunal and Appellate Tribunal
413. Term of office of President, chairperson and other Members
414. Salary, allowances and other terms and conditions of service of Members
425. Power to punish for contempt

8) In the prayer clause, constitutional validity of Sections 415, 418, 424, 426, 431 and 434 have also been questioned. At the time of hearing, no arguments were addressed by Mr. Datar, learned senior counsel for the petitioner on the aforesaid provisions. Therefore, in respect of these provisions, we are eschewing our discussion.

9) On the reading of the aforesaid provisions and having regard to the arguments advanced at the Bar, we can conveniently categorise the challenge in three compartments, as under:

(i) Challenge to the validity of the constitution of NCT and NCLAT;

(ii) Challenge to the prescription of qualifications including term of their office and salary allowances etc. of President and Members of the NCLT and as well as Chairman and Members of the NCLAT;

(iii) Challenge to the structure of the Selection Committee for appointment of President/Members of the NCLT and Chairperson/ Members of the NCLAT.

Incidental issues pertaining to the power given to these bodies to punish for contempt as mentioned in Section 425 and giving power to Central Government to constitute the Benches are also raised by the petitioner.

As would be discussed hereinafter, all these issues stand covered by Madras Bar Association (supra) and answer to these questions is available therein. In fact, after detailed discussion on each issue, the Court pronounced the verdict. Therefore, while doing a diagnostic of sorts of the issues raised, we shall be administering the treatment that is prescribed in that judgment.

ISSUE NO.1

Re .: Constitutional validity of NCT and NCLAT

Section 408 of the Act, 2013 deals with the constitution of NCLT.

By virtue of this Section, Central Government is empowered to issue notification for constituting a Tribunal to be known as 'National Company Law Tribunal'. This Tribunal would consist of President and such number of Judicial and Technical members, as the Central Government may deem necessary, to be appointed by it. By Notification dated 12.09.2013, the Central Government has constituted the NCLT. Likewise, Section 410 of the

Act, 2013 arms the Central Government with power to constitute NCLAT by notification. This NCLAT is also to consist of a Chairman and such number of Judicial and Technical Members, not exceeding eleven, as the Central Government may deem fit, to be appointed by it by notification. By the aforesaid Notification dated 12.09.2013, NCLAT has also been constituted by the Central Government.

10) It is pertinent to point out that in the prayer clause, though challenge is laid to the vires of Section 408, it conspicuously omits Section 410 and, thus, in essence, there is no challenge to the constitution of NCLAT insofar as relief claimed is concerned. Moreover, as pointed out above, the entire writ petition takes umbrage under the Constitution Bench judgment in 2010 judgment. However, at the time of arguments, Mr. Datar primarily challenged the Constitutional validity of NCLAT without making any serious efforts to challenge the constitution of NCLT. As far as NCLT is concerned, he almost conceded that validity thereof stands upheld in 2010 judgment and there is not much to argue. In respect of NCLAT, though he conceded that validity thereof is also upheld in the aforesaid judgment, his endeavour was to demonstrate that there is no discussion in the entire judgment insofar as NCLAT is concerned and, therefore, conclusion which is mentioned in the said judgment at the end, should not be treated as binding or to be taken as having decided this issue. His submission was that in view of the subsequent Constitution Bench judgment of this Court in *Madras Bar Association v. Union of India*, wherein establishment of National Tax Tribunal has been held to be unconstitutional, Section 410 should also be meted out the same treatment for the reasons recorded in the said judgment pertaining to National Tax Tribunal. It is difficult to digest this argument for various reasons, which we record in the discussion hereafter.

11) First of all the creation of Constitution of NCLAT has been specifically upheld in 2010 judgment. It cannot be denied that this very petitioner had specifically questioned the Constitutional validity of NCLAT in the earlier writ petition and even advanced the arguments on this very issue. This fact is specifically noted in the said judgment. The provision pertaining to the constitution of the Appellate Tribunal i.e. Section 10FR of the Companies Act, 1956 was duly taken note of. Challenge was laid to the establishments of NCLT as well as NCLAT on the ground that the Parliament had resorted to tribunalisation by taking away the powers from the normal courts which was essentially a judicial function and this move of the Legislature impinged upon the impartiality, fairness and reasonableness of the decision making which was the hallmark of judiciary and essentially a judicial function. Argument went to the extent that it amounted to negating the Rule of Law and trampling of the Doctrine of Separation of Powers which was the basic feature of the Constitution of India. What we are emphasising is that the petitions spearheaded the attack on the constitutional validity of both NCLT as well as NCLAT on these common grounds. The Court specifically went into the gamut of all those arguments raised and emphatically repelled the same.

12) The Court specifically rejected the contention that transferring judicial function, traditionally performed by the Courts, to the Tribunals offended the basic structure of the Constitution and summarised the position in this behalf as under:
"We may summarize the position as follows:

(a) A legislature can enact a law transferring the jurisdiction exercised by courts in regard to any specified subject (other than those which are vested in courts by express provisions of the Constitution) to any tribunal.
(b) All courts are tribunals. Any tribunal to which any existing jurisdiction of courts is transferred should also be a Judicial Tribunal. This means that such Tribunal should have as members, persons of a rank, capacity and status as nearly as possible equal to the rank, status and capacity of the court which was till then dealing with such matters and the members of the Tribunal should have the independence and security of tenure associated with Judicial Tribunals.
(c) Whenever there is need for `Tribunals', there is no presumption that there should be technical members in the Tribunals. When any jurisdiction is shifted from courts to Tribunals, on the ground of pendency and delay in courts, and the jurisdiction so transferred does not involve any technical aspects requiring the assistance of experts, the Tribunals should normally have only judicial members. Only where the exercise of jurisdiction involves inquiry and decisions into technical or special aspects, where presence of technical members will be useful and necessary, Tribunals should have technical members. Indiscriminate appointment of technical members in all Tribunals will dilute and adversely affect the independence of the Judiciary.
(d) The Legislature can re-organize the jurisdictions of Judicial Tribunals. For example, it can provide that a specified category of cases tried by a higher court can be tried by a lower court or vice versa (A standard example is the variation of pecuniary limits of courts). Similarly while constituting Tribunals, the Legislature can prescribe the qualifications/ eligibility criteria. The same is however subject to Judicial Review. If the court in exercise of judicial review is of the view that such tribunalisation would adversely affect the independence of judiciary or the standards of judiciary, the court may interfere to preserve the independence and standards of judiciary. Such an exercise will be part of the checks and balances measures to maintain the separation of powers and to prevent any encroachment, intentional or unintentional, by either the legislature or by the executive."

13) Thereafter, the Constitution Bench categorically dealt with the Constitutional validity of NCLT and NCLAT under the caption "Whether the constitution of NCLT and NCLAT under Parts 1B & 1C of Companies Act are valid", and embarked upon the detailed discussion on this topic. It becomes manifest from the above that the question of validity of NCLAT was directly and squarely in issue. Various facets of the challenge laid to the validity of these two fora were thoroughly thrashed out. No doubt, most of the discussion contained in paras 107 to 119 refers to NCLT. However, on an insight into the said discussion contained in these paragraphs, would eloquently bear it out that it is inclusive of NCLAT as well. In para 121 of the judgment, which is already extracted above, the Court specifically affirmed the decision of the High Court which held that creation of NCLT and NCLAT was not unconstitutional. In

view of this, it is not open to the petitioner even to argue this issue as it clearly operate as res judicata.

14) Frankly, Mr. Datar was conscious of the aforesaid limitation. He still ventured to attack the setting up of NCLAT on the ground that insofar as this appellate forum is concerned, there are no reasons given in the said judgment and thereafter this aspect has been dealt with in more details in the NTT judgment wherein formation of National Tax Tribunal has been held to be unconstitutional. This adventurism on the part of the petitioner is totally unfounded. In the first instance, as mentioned above, insofar as NCLAT is concerned, its validity has already been upheld and this issue cannot be reopened. Judgment in the case of 2010 judgment is of a Constitution Bench and that judgment of a co-ordinate Bench binds this Bench as well.

15) Secondly, reading of the Constitution Bench judgment in the matter of National Tax Tribunal would manifest that not only 2010 judgment was taken note of but followed as well. The Court spelled out the distinguishing features between NCLT/NCLAT on the one hand and NTT on the other hand in arriving at a different conclusion.

16) Thirdly, the NTT was a matter where power of judicial review hitherto exercised by the High Court in deciding the pure substantial question of law was sought to be taken away to be vested in NTT which was held to be impermissible. In the instant case, there is no such situation. On the contrary, NCLT is the first forum in the hierarchy of quasi-judicial fora set up in the Act, 2013. The NCLT, thus, would not only deal with question of law in a given case coming before it but would be called upon to thrash out the factual disputes/aspects as well. In this scenario, NCLAT which is the first appellate forum provided under the Act, 2013 to examine the validity of the orders passed by NCLT, will have to revisit the factual as well as legal issues. Therefore, situation is not akin to NTT. Jurisdiction of the Appellate Tribunal is mentioned in Section 410 itself which stipulates that NCLAT shall be constituted 'for hearing appeals against the orders of the Tribunal'. This jurisdiction is not circumscribed by any limitations of any nature whatsoever and the implication thereof is that appeal would lie both on the questions of facts as well as questions of law. Likewise, under sub-section (4) of Section 421, which provision deals with 'appeal from orders of Tribunal', it is provided that the NCLAT, after giving reasonable opportunity of being heard, 'pass such orders thereon as it thinks fit, forming, modifying or set aside the order appealed against'. It is thereafter further appeal is provided from the order of the NCLAT to the Supreme Court under Section 423 of the Act, 2013. Here, the scope of the appeal to the Supreme Court is restricted only 'to question of law arising out of such order'.

17) Fourthly, it is not unknown rather a common feature/practice to provide one appellate forum wherever an enactment is a complete Code for providing judicial remedies. Providing one right to appeal before an appellate forum is a well accepted norm which is perceived as a healthy tradition.

18) For all these reasons, we hold that there is no merit in this issue.

ISSUE NO.2

19) Qualifications of President and Members of NCLT are mentioned in Section 409 of the Act, 2013 and that of Chairperson and Members of NCLAT are stipulated in Section 411 of the Act, 2013. The petitioner has no quarrel about the qualifications mentioned for the President and Judicial Members of the Tribunal as well as Chairperson and Judicial Members of the Appellate Tribunal. However, it is argued that insofar as technical Members of NCLT/NCLAT are concerned, the provision is almost the same which was inserted by way of an amendment in the Act,1956 and challenge to those provisions was specifically upheld finding fault therewith.

20) It was pointed out that in the 2010 judgment, the Constitution Bench took the view that since the NCLT would now be undertaking the work which is being performed, inter alia, by High Court, the technical Members of the NCLT/NCLAT should be selected from amongst only those officers who hold rank of Secretaries or Additional Secretaries and have technical expertise. These aspects are discussed by the Court in the following paragraphs:

> "108. The legislature is presumed not to legislate contrary to the rule of law and therefore know that where disputes are to be adjudicated by a Judicial Body other than Courts, its standards should approximately be the same as to what is expected of main stream Judiciary. Rule of law can be meaningful only if there is an independent and impartial judiciary to render justice. An independent judiciary can exist only when persons with competence, ability and independence with impeccable character man the judicial institutions. When the legislature proposes to substitute a Tribunal in place of the High Court to exercise the jurisdiction which the High Court is exercising, it goes without saying that the standards expected from the Judicial Members of the Tribunal and standards applied for appointing such members, should be as nearly as possible as applicable to High Court Judges, which are apart from a basic degree in law, rich experience in the practice of law, independent outlook, integrity, character and good reputation. It is also implied that only men of standing who have special expertise in the field to which the Tribunal relates, will be eligible for appointment as Technical members. Therefore, only persons with a judicial background, that is, those who have been or are Judges of the High Court and lawyers with the prescribed experience, who are eligible for appointment as High Court Judges, can be considered for appointment of Judicial Members.
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> 109. A lifetime of experience in administration may make a member of the civil services a good and able administrator, but not a necessarily good, able and impartial adjudicator with a judicial temperament capable of rendering decisions which have to
> (i) inform the parties about the reasons for the decision;
> (ii) demonstrate fairness and correctness of the

decision and absence of arbitrariness; and
(iii) ensure that justice is not only done, but also seem to be done.

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111. As far as the technical members are concerned, the officer should be of at least Secretary Level officer with known competence and integrity. Reducing the standards, or qualifications for appointment will result in loss of confidence in the Tribunals. We hasten to add that our intention is not to say that the persons of Joint Secretary level are not competent. Even persons of Under Secretary level may be competent to discharge the functions. There may be brilliant and competent people even working as Section Officers or Upper Division Clerks but that does not mean that they can be appointed as Members. Competence is different from experience, maturity and status required for the post. As, for example, for the post of a Judge of the High Court, 10 years' practice as an Advocate is prescribed. There may be Advocates who even with 4 or 5 years' experience may be more brilliant than Advocates with 10 years' standing. Still, it is not competence alone but various other factors which make a person suitable. Therefore, when the legislature substitutes the Judges of the High Court with Members of the Tribunal, the standards applicable should be as nearly as equal in the case of High Court Judges. That means only Secretary Level officers (that is those who were Secretaries or Additional Secretaries) with specialized knowledge and skills can be appointed as Technical Members of the tribunal.

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118. Parts IC and ID of the Companies Act proposes to shift the company matters from the courts to Tribunals, where a `Judicial Member' and a `Technical Member' will decide the disputes. If the members are selected as contemplated in section 10FD, there is every likelihood of most of the members, including the so called `Judicial Members' not having any judicial experience or company law experience and such members being required to deal with and decide complex issues of fact and law. Whether the Tribunals should have only judicial members or a combination of judicial and technical members is for the Legislature to decide. But if there should be technical members, they should be persons with expertise in company law or allied subjects and mere experience in civil service cannot be treated as Technical Expertise in company law. The candidates falling under sub-section 2(c) and (d) and sub-sections 3(a) and (b) of section 10FD have no experience or expertise in deciding company matters.

119. There is an erroneous assumption that company law matters require certain specialized skills which are lacking in Judges. There is also an equally erroneous assumption that members of the civil services, (either a Group-A officer or Joint Secretary level civil servant who had never handled any company disputes) will have the judicial experience or expertise in company law to be appointed either as Judicial Member or Technical Member. Nor can persons having experience of fifteen years in science, technology, medicines, banking, industry can be termed

as experts in Company Law for being appointed as Technical Members. The practice of having experts as Technical Members is suited to areas which require the assistance of professional experts, qualified in medicine, engineering, and architecture etc. Lastly, we may refer to the lack of security of tenure. The short term of three years, the provision for routine suspension pending enquiry and the lack of any kind of immunity, are aspects which require to be considered and remedied."

21) On the basis of the aforesaid discussions, parts 1C and 1D of the Act, 1956 as they existed were treated as invalid and in order to bring these provisions within the realm of Constitutionality, the Court pointed out the corrections which were required to be made to remove those anamolies. Para 120 of the judgment is most relevant to answer the issue at hand
and, therefore, we reproduce the said para in its entirety:

"120. We may tabulate the corrections required to set right the defects in Parts IB and IC of the Act :
(i) Only Judges and Advocates can be considered for appointment as Judicial Members of the Tribunal. Only the High Court Judges, or Judges who have served in the rank of a District Judge for at least five years or a person who has practiced as a Lawyer for ten years can be considered for appointment as a Judicial Member. Persons who have held a Group A or equivalent post under the Central or State Government with experience in the Indian Company Law Service (Legal Branch) and Indian Legal Service (Grade-1) cannot be considered for appointment as judicial members as provided inm sub-section 2(c) and (d) of Section 10FD. The expertise in Company Law service or Indian Legal service will at best enable them to be considered for appointment as technical members.

(ii) As NCLT takes over the functions of High Court, the members should as nearly as possible have the same position and status as High Court Judges. This can be achieved, not by giving the salary and perks of a High Court Judge to the members, but by ensuring that persons who are as nearly equal in rank, experience or competence to High Court Judges are appointed as members. Therefore, only officers who are holding the ranks of Secretaries or Additional Secretaries alone can be considered for appointment as Technical members of the National Company Law Tribunal. Clauses (c) and (d) of sub-section (2) and Clauses (a) and (b) of sub-section (3) of section 10FD which provide for persons with 15 years experience in Group A post or persons holding the post of Joint Secretary or equivalent post in Central or State Government, being qualified for appointment as Members of Tribunal is invalid.

(iii) A `Technical Member' presupposes an experience in the field to which the Tribunal relates. A member of Indian Company Law Service who has worked

with Accounts Branch or officers in other departments who might have incidentally dealt with some aspect of Company Law cannot be considered as `experts' qualified to be appointed as Technical Members. Therefore Clauses (a) and (b) of sub-section (3) are not valid.

(iv) The first part of clause (f) of sub-section (3) providing that any person having special knowledge or professional experience of 20 years in science, technology, economics, banking, industry could be considered to be persons with expertise in company law, for being appointed as Technical Members in Company Law Tribunal, is invalid.

(v) Persons having ability, integrity, standing and special knowledge and professional experience of not less than fifteen years in industrial finance, industrial management, industrial reconstruction, investment and accountancy, may however be considered as persons having expertise in rehabilitation/ revival of companies and therefore, eligible for being considered for appointment as Technical Members.

(vi) In regard to category of persons referred in clause (g) of sub-section (3) at least five years experience should be specified.

(vii) Only Clauses (c), (d), (e), (g), (h), and later part of clause (f) in sub-section (3) of section 10FD and officers of civil services of the rank of the Secretary or Additional Secretary in Indian Company Law Service and Indian Legal Service can be considered for purposes of appointment as Technical Members of the Tribunal.

(viii) Instead of a five-member Selection Committee with Chief Justice of India (or his nominee) as Chairperson and two Secretaries from the Ministry of Finance and Company Affairs and the Secretary in the Ministry of Labour and Secretary in the Ministry of Law and Justice as members mentioned in section 10FX, the Selection Committee should broadly be on the following lines:

> (a) Chief Justice of India or his nominee – Chairperson (with a casting vote);
> (b) A senior Judge of the Supreme Court or Chief Justice of High Court – Member;
> (c) Secretary in the Ministry of Finance and Company Affairs - Member; and
> (d) Secretary in the Ministry of Law and Justice - Member.

(ix) The term of office of three years shall be changed to a term of seven or five years subject to eligibility for appointment for one more term. This is because considerable time is required to achieve expertise in the concerned

field. A term of three years is very short and by the time the members achieve the required knowledge, expertise and efficiency, one term will be over. Further the said term of three years with the retirement age of 65 years is perceived as having been tailor-made for persons who have retired or shortly to retire and encourages these Tribunals to be treated as post-retirement havens. If these Tribunals are to function effectively and efficiently they should be able to attract younger members who will have a reasonable period of service.

(x) The second proviso to Section 10FE enabling the President and members to retain lien with their parent cadre/ ministry/department while holding office as President or Members will not be conducive for the independence of members. Any person appointed, as members should be prepared to totally disassociate himself from the Executive. The lien cannot therefore exceed a period of one year.

(xi) To maintain independence and security in service, sub-section (3) of section 10FJ and Section 10FV should provide that suspension of the President/Chairman or member of a Tribunal can be only with the concurrence of the Chief Justice of India.

(xii) The administrative support for all Tribunals should be from the Ministry of Law & Justice. Neither the Tribunals nor its members shall seek or be provided with facilities from the respective sponsoring or parent Ministries or concerned Department.

(xiii) Two-Member Benches of the Tribunal should always have a judicial member. Whenever any larger or special benches are constituted, the number of Technical Members shall not exceed the Judicial Members."

22) What gets revealed from the reading of para 120, particularly, sub-para (ii) thereof that only officers who are holding the ranks of Secretaries or Additional Secretaries alone are to be considered for appointment as technical Members of NCLT. Provisions contained in clauses (c) and (d) of sub-section (2) and Clause (a) and (b) of sub-section (3) of Section 10FD which made Joint Secretaries with certain experience as eligible, were specifically declared as invalid. Notwithstanding the same, Section 409(3) of the Act, 2013 again makes Joint Secretary to the Government of India or equivalent officer eligible for appointment, if he has 15 years experience as member of Indian Corporate Law Service or Indian Legal Service, out of which at least 3 years experience in the pay scale of Joint Secretary. This is clearly in the teeth of dicta pronounced in 2010 judgment.

23) In the counter affidavit, the respondents have endeavored to justify this provision by stating that this variation was made in view of the lack of available officers at Additional Secretary level in Indian Companies Law Service. It is further mentioned that functionally the levels of Additional Secretary and Joint Secretary are similar. These officers have knowledge

of specific issues concerning operations and working of companies and their expertise in company law which is expected to benefit NCLT. Such an explanation is not legally sustainable, having regard to the clear mandate of 2010 judgment. We would like to point out that apart from giving other reasons for limiting the consideration for such posts to Secretary and Additional Secretary, there was one very compelling factor in the mind of the Court viz. gradual erosion of independence of judiciary, which was perceived as a matter of concern. This aspect was demonstrated with specific examples in certain enactments depicting gradual dilution of the standards and qualifications prescribed for persons to decide cases which were earlier being decided by the High Court. We, thus, deem it apposite to reproduce that discussion which provides a complete answer to the aforesaid argument taken by the respondents. The said discussion, contained in para 112, with its sub-paras, reads as under:

> "112. What is a matter of concern is the gradual erosion of the independence of the judiciary, and shrinking of the space occupied by the Judiciary and gradual increase in the number of persons belonging to the civil service discharging functions and exercising jurisdiction which was previously exercised by the High Court. There is also a gradual dilution of the standards and qualification prescribed for persons to decide cases which were earlier being decided by the High Courts. Let us take stock.
>
> 112.1 To start with, apart from jurisdiction relating to appeals and revisions in civil, criminal and tax matters (and original civil jurisdiction in some High Courts). The High Courts were exercising original jurisdiction in two important areas; one was writ jurisdiction under Articles 226 and 227 (including original jurisdiction in service matters) and the other was in respect to company matters.
>
> 112.2 After constitution of Administrative Tribunals under the Administrative Tribunals Act, 1985 the jurisdiction in regard to original jurisdiction relating to service matters was shifted from High Courts to Administrative Tribunals. Section 6 of the said Act deals with qualifications for appointment as Chairman, and it is evident therefrom that the Chairman has to be a High Court Judge either a sitting or a former Judge. For judicial member the qualification was that he should be a judge of a High Court or is qualified to be a Judge of the High Court (i.e. an advocate of the High Court with ten years practice or a holder of a judicial office for ten years) or a person who held the post of Secretary, Govt. of India in the Department of Legal Affairs or in the Legislative Department or Member Secretary, Law Commission of India for a period of two years; or an Additional Secretary to Government of India in the Department of Legal Affairs or Legislative Department for a period of five years.
>
> 112.3 For being appointed as Administrative Member, the qualification was that the candidate should have served as Secretary to the Government of India

or any other post of the Central or State Government carrying the scale of pay which is not less than as of a Secretary of Government of India for atleast two years, or should have held the post of Additional Secretary to the Government of India or any other post of Central or State Government carrying the scale of pay which is not less than that of an Additional Secretary to the Government of India at least for a period of five years. In other words, matters that were decided by the High Courts could be decided by a Tribunal whose members could be two Secretary level officers with two years experience or even two Additional Secretary level officers with five years experience. This was the first dilution.

112.4 The members were provided a term of office of five years and could hold office till 65 years and the salary and other perquisites of these members were made the same as that of High Court Judges. This itself gave room for a comment that these posts were virtually created as sinecure for members of the executive to extend their period of service by five years from 60 to 65 at a higher pay applicable to High Court Judges. Quite a few members of the executive thus became members of the "Tribunals exercising judicial functions".

112.5 We may next refer to Information Technology Act, 2000 which provided for establishment of Cyber Appellate Tribunal with a single member. Section 50 of that Act provided that aperson who is, or has been, or is qualified to be, a Judge of a High Court, or a person who is, or has been, a member of the India Legal Service and is holding or has held a post in Grade I of that service for at least three years could be appointed as the Presiding Officer. That is, the requirement of even a Secretary level officer is gone. Any member of Indian Legal Service holding a Grade-I Post for three years can be a substitute for a High Court Judge.

112.6 The next dilution is by insertion of Chapters 1B in the Companies Act, 1956 with effect from 1.4.2003 providing for constitution of a National Company Law Tribunal with a President and a large number of Judicial and Technical Members (as many as 62). There is a further dilution in the qualifications for members of National Company Law Tribunal which is a substitute for the High Court, for hearing winding up matters and other matters which were earlier heard by High Court. A member need not even be a Secretary or Addl. Secretary Level Officer. All Joint Secretary level civil servants (that are working under Government of India or holding a post under the Central and State Government carrying a scale of pay which is not less than that of the Joint Secretary to the Government of India) for a period of five years are eligible. Further, any person who has held a Group-A post for 15 years (which means anyone belonging to Indian P&T Accounts & Finance Service, Indian Audit and Accounts Service, Indian Customs & Central Excise

> Service, Indian Defence Accounts Service, Indian Revenue Service, Indian Ordnances Factories Service, Indian Postal Service, Indian Civil Accounts Service, Indian Railway Traffic Service, Indian Railway Accounts Service, Indian Railway Personal Service, Indian Defence Estates Service, Indian Information Service, Indian Trade Services, or other Central or State Service) with three years' of service as a member of Indian Company Law Service (Account) Branch, or who has `dealt' with any problems relating to Company Law can become a Member. This means that the cases which were being decided by the Judges of the High Court can be decided by two-members of the civil services - Joint Secretary level officers or officers holding Group `A' posts or equivalent posts for 15 years, can now discharge the functions of High Court. This again has given room for comment that qualifications prescribed are tailor made to provide sinecure for a large number of Joint Secretary level officers or officers holding Group `A' posts to serve up to 65 years in Tribunals exercising judicial functions.
>
> 112.7 The dilution of standards may not end here. The proposed Companies Bill, 2008 contemplates that any member of Indian Legal Service or Indian Company Law Service (Legal Branch) with only ten years service, out of which three years should be in the pay scale of Joint Secretary, is qualified to be appointed as a Judicial Member. The speed at which the qualifications for appointment as Members is being diluted is, to say the least, a matter of great concern for the independence of the Judiciary."

24) Having regard to the aforesaid clear and categorical dicta in 2010 judgment, tinkering therewith would evidently have the potential of compromising with standards which 2010 judgment sought to achieve, nay, so zealously sought to secure. Thus, we hold that Section 409(3)(a) and (c) are invalid as these provisions suffer from same vice. Likewise, Section 411(3) as worded, providing for qualifications of technical Members, is also held to be invalid. For appointment of technical Members to the NCLT, directions contained in sub-para (ii), (iii), (iv), (v) of para 120 of 2010 judgment will have to be scrupulously followed and these corrections are required to be made in Section 409(3) to set right the defects contained therein. We order accordingly, while disposing of issue No.2.

ISSUE NO.3

25) This issue pertains to the constitution of Selection Committee for selecting the Members of NCLT and NCLAT. Provision in this respect is contained in Section 412 of the Act, 2013. Sub-section (2) thereof provides for the Selection Committee consisting of:

(a) Chief Justice of India or his nominee-Chairperson;
(b) a senior Judge of the Supreme Court or a Chief Justice of High Court— Member;
(c) Secretary in the Ministry of Corporate Affairs—Member;
(d) Secretary in the Ministry of Law and Justice—Member; and (e) Secretary in the

Department of Financial Services in the Ministry of Finance— Member.

Provision in this behalf which was contained in Section 10FX, validity thereof was questioned in 2010 judgment, was to the following effect:

> "10FX. Selection Committee:
> (1) The Chairperson and Members of the Appellate Tribunal and
> President and Members of the Tribunal shall be appointed by the Central Government on the recommendations of a Selection Committee consisting of:
>
> (a) Chief Justice of India or his nominee Chairperson;
> (b) Secretary in the Ministry of Finance and Member; Company Affairs
> (c) Secretary in the Ministry of Labour Member;
> (d) Secretary in the Ministry of Law and Justice (Department of Legal Affairs or Legislative
> Department) Member;
> (e) Secretary in the Ministry of Finance and Company Affairs (Department of Company Affairs) Member.
>
> (2) The Joint Secretary in the Ministry or Department of the Central Government dealing with this Act shall be the Convenor of the Selection Committee."

26) The aforesaid structure of the Selection Committee was found fault with by the Constitution Bench in 2010 judgment. The Court specifically remarked that instead of 5 members Selection Committee, it should be 4 members Selection Committee and even the composition of such a
Selection Committee was mandated in Direction No.(viii) of para 120 and this sub-para we reproduce once again hereinbelow:

> "(viii) Instead of a five-member Selection Committee with Chief Justice of India (or his nominee) as Chairperson and two Secretaries from the Ministry of Finance and Company
> Affairs and the Secretary in the Ministry of Labour and Secretary in the Ministry of Law and Justice as members mentioned in section 10FX, the Selection Committee should broadly be on the following lines:
> (a) Chief Justice of India or his nominee – Chairperson (with a casting vote);
> (b) A senior Judge of the Supreme Court or Chief Justice of High Court – Member;
> (c) Secretary in the Ministry of Finance and Company Affairs - Member; and
> (d) Secretary in the Ministry of Law and Justice – Member."

27) Notwithstanding the above, there is a deviation in the composition of Selection Committee that is prescribed under Section 412 (2) of the Act, 2013. The deviations are as

under:

> (i) Though the Chief Justice of India or his nominee is to act as Chairperson, he is not given the power of a casting vote. It is because of the reason that instead of four member Committee, the composition of Committee in the impugned provision is that of five members.
> (ii) This Court had suggested one Member who could be either Secretary in the Ministry of Finance or in Company Affairs (we may point out that the word "and" contained in Clause (c) of sub-para (viii) of para 120 seems to be typographical mistake and has to be read as "or", as otherwise it won't make any sense).
> (iii) Now, from both the Ministries, namely from the Ministry of Corporate Affairs as well as Ministry of Finance, one Member each is included. Effect of this composition is to make it a five members Selection Committee which was not found to be valid in 2010 judgment. Reason is simple, out of these five Members, three are from the administrative branch/bureaucracy as against two from judiciary which will result in predominant say of the members belonging to the administrative branch, is situation that was specifically diverted from. The composition of Selection Committee contained in Section 412(2) of the Act, 2013 is sought to be justified by the respondents by arguing that the recommended composition in the 2010 judgment was in broad terms. It is argued that in view of subsuming of BIFR and AAIFR which are in the administrative jurisdiction of Department of Financial Services, Secretary DFS has beenincluded. No casting vote has been provided for the Chairman as over the period of time the selection processes in such committees have crystallized in a manner that the recommendations have been unanimous and there is no instance of voting in such committees in Ministry of Corporate Affairs. Moreover other similar statutory bodies/tribunals also do not provide for 'casting vote' to Chairperson of Selection Committee. Further, the Committee will be deciding its own modalities as provided in the Act. The following argument is also raised to justify this provision: (i) Robust and healthy practices have evolved in deliberations of Selection Committees. Till now there is no known case of any material disagreement in such committees. (ii) The intention is to man the Selection Committee with persons of relevant experience and knowledge.

28) We are of the opinion that this again does not constitute any valid or legal justification having regard to the fact that this very issue stands concluded by the 2010 judgment which is now a binding precedent and, thus, binds the respondent equally. The prime consideration in the mind of the Bench was that it is the Chairperson, viz. Chief Justice of India, or his nominee who is to be given the final say in the matter of selection with right to have a casting vote. That is the ratio of the judgment and reasons for providing such a composition are not far to seek. In the face of the all pervading prescript available on this very issue in the form of a binding precedent, there is no scope for any relaxation as sought to be achieved through the

impugned provision and we find it to be incompatible with the mandatory dicta of 2010 judgment. Therefore, we hold that provisions of Section 412(2) of the Act, 2013 are not valid and direction is issued to remove the defect by bringing this provision in accord with sub-para (viii) of para 120 of 2010 judgment.

29) We now deal with some other issues raised in the petition. It was feebly argued by Mr. Datar that power to punish for contempt as given to the NCLT and NCLAT under Section 425 of the Act is not healthy and should be done away with. It was also argued that power given to the Central Government to constitute the Benches is again impermissible as such power should rest with President, NCLT or Chairman, NCLAT. However, we hardly find any legal strength in these arguments. We have to keep in mind that these provisions are contained in a statute enacted by the Parliament and the petitioner could not point out as to how such provisions are unconstitutional.

30) The upshot of the aforesaid discussion is to allow this writ petition partly, in the manner mentioned above.

31) Before we part, we must mention that the affidavit dated 07.05.2015 is filed on behalf of the respondents mentioning therein the steps that have been taken till date towards setting up of NCLT and NCLAT. It is pointed out that the approval for creation of one post of Chairperson and five posts of Members of NCLAT as well as one post of President and 62 posts of Members of NCLT and two posts of Registrar one each for NCLT and NCLAT and one post of Secretary, NCLT was obtained and the approval was also obtained for creation of 246 posts of supporting staff of NCLT and NCLAT. It is also mentioned that following draft Rules have already been prepared in consultation with the Legislative Department, Ministry of Law:
(i) NCLAT (Salaries, Allowances and other terms and conditions of service of the Chairperson and other Members) Rules, 2014, (ii) NCLT (Salary, Allowances and other Terms and Conditions of Service of President and other Members) Rules, 2013. Draft Recruitment Rules for the supporting staff were also prepared in consultation with Legislative Department, Ministry of Law. It is further mentioned that draft Rules with regard to manner of functioning of NCLT/NCLAT etc. were prepared in order to place them before the Chairperson/President of NCLAT/NCLT on their appointment for finalization as per the provisions of the Companies Act, 2013. These Rules cover provisions with regard to manner of functioning of NCLT/NCLAT; manner in which applications for various approvals shall be made by applicants and approved; and specific procedural requirements with regard to applications/matters relating to compromises/arrangements/ amalgamations; prevention of oppression and mismanagement; revival and rehabilitation of sick companies; winding up and other miscellaneous requirements. Space for Principal Bench and other Benches of NCLT, including a special Bench at Delhi to deal with transferred cases of BIFR and AAIFR had also been identified.
Process initiated for renting space in some locations, which was discontinued in view of the pending petition, can be restarted at a short notice. Budget heads have been created for meeting the expenditure for NCLT and NCLAT. Allocated funds for 2014-2015 had to be

surrendered in view of the delay in settling up the Tribunals. 32) From the aforesaid, it seems the only step which is left to make NCLT and NCLAT functional is to appoint President and Members of NCLT and Chairperson and Members of NCLAT.

33) Since, the functioning of NCLT and NCLAT has not started so far and its high time that these Tribunals start functioning now, we hope that the respondents shall take remedial measures as per the directions contained in this judgment at the earliest, so that the NCLT & NCLAT are adequately manned and start functioning in near future.

34) Writ petition stands disposed of in the aforesaid manner.

Embassy Property Developments Pvt. Ltd. v. State of Karnataka and Ors.

MANU/SC/1661/2019

[M/s.Udhyaman Investments Pvt. Ltd. (The twelfth Respondent), claiming to be a Financial Creditor, moved an application before the NCLT Chennai, under Section 7 of the Insolvency and Bankruptcy Code, 2016 against the Corporate Debtor (M/s.Tiffins Barytes Asbestos & Paints Ltd.). By and Order dated 12.03.20 the NCLT Chennai admitted the application, ordered the commencement of the Corporate Insolvency Resolution Process and appointed an Interim Resolution Professional. The Corporate Debtor held a mining lease granted by the Government of Karnataka, which was to expire by 25.05.2018. Though a notice for premature termination of the lease had already been issued on 09.08.2017, on the allegation of violation of statutory Rules and the terms and conditions of the lease deed, no order of termination had been passed till the date of initiation of the Corporate Insolvency Resolution Process (CIRP). The Interim Resolution Professional appointed by NCLT wrote a letter dated 21.04.2018to the Director of Mines and Geology, seeking the benefit of deemed extension of the lease. The Government passed an order dated 26.09.2018 rejecting the proposal for deemed extension, on the ground that the Corporate Debtor had contravened not only the terms and conditions of the Lease Deed but also the provisions of Rule 37 of the Mineral Concession Rules, 1960 and Rule 24 of the Minerals Rules, 2016. The Resolution Professional moved a Miscellaneous Application No. 632 of 2018, before the NCLT Chennai, praying for setting aside the Order of the Government of Karnataka. The NCLT an Order dated 11.12.2018 allowed the Miscellaneous Application, setting aside the order of rejection and directed the Government of Karnataka to execute Supplemental Lease Deeds. Challenging the Order of the NCLT Chennai, the Government of Karnataka moved a writ petition before the High Court. The High Court, by Order dated 12.09.2019 granted an interim stay of operation of the direction contained in the impugned Order of the Tribunal.

It is against the said ad Interim Order granted by the High Court that the Resolution Applicant, the Resolution Professional and the Committee of Creditors have filed the present Appeal before the Supreme Court – held- ***The NCLT, being a creature of a special statute to discharge certain specific functions, cannot be elevated to the status of a superior court having the power of judicial review over administrative action.****]*

Hon'ble Judges/Coram: Rohinton Fali Nariman, Aniruddha Bose and V. Ramasubramanian, JJ.

V. Ramasubramanian, J. – 2. Two seminal questions of importance namely:

i) Whether the High Court ought to interfere, Under Article 226/227 of the Constitution, with an Order passed by the National Company Law Tribunal in a proceeding under the Insolvency

and Bankruptcy Code, 2016, ignoring the availability of a statutory remedy of appeal to the National Company Law Appellate Tribunal and if so, under what circumstances; and

ii) Whether questions of fraud can be inquired into by the NCLT/NCLAT in the proceedings initiated under the Insolvency and Bankruptcy Code, 2016, arise for our consideration in these appeals.

9. In response, Sh. K.K. Venugopal, learned Attorney General submitted that if a case falls under the category of inherent lack of jurisdiction on the part of a Tribunal, the exercise of jurisdiction by the Tribunal would certainly be amenable to the jurisdiction of the High Court Under Article 226. Since the contours of jurisdiction of NCLT are defined in Clauses (a), (b) and (c) of Sub-section (5) of Section 60 and also since the powers of the NCLT are defined in Sub-section (4) of Section 60, to be akin to those of the Debts Recovery Tribunal under the Recovery of Debts Due to Banks and Financial Institutions Act of 1993 (hereinafter referred to as *DRT Act, 1993*), it was contended by the learned Attorney General that the jurisdiction of the NCLT is confined only to contractual matters inter-parties. An order passed by a statutory/quasi-judicial authority under certain special enactments such as the MMDR Act, 1957 falls in the realm of public law and hence it was contended by the learned Attorney General that the NCLT would have no power of judicial review of such orders. The learned Attorney General also drew our attention to the minutes of the 10th meeting of the Committee of Creditors held on 27.02.2019, in which a Company other than the present Resolution Applicant was recorded to have made a better offer. But the present Resolution Applicant was able to have his plan approved, despite the offer being lesser, only because they were willing to take the risk of the mining lease not being renewed. Therefore, it was his contention that a person who was willing to take a chance, cannot now take shelter under the approval of the Resolution Plan. On the contention that the Government of Karnataka had an efficacious alternative remedy before the NCLAT, the learned Attorney General submitted, on the basis of the decision in ***Barnard and Ors. v. National Dock Labour Board and Ors.*** (1953) 2 WLR 995 that when an inferior Tribunal passes an Order which is a nullity, the superior Court need not drive the party to the appellate forum stipulated by the Act. The learned Attorney General also relied upon the decision of this Court in ***The State of Uttar Pradesh v. Mohammad Nooh*** (1958) SCR 595.

10. In the backdrop of the facts narrated and in the light of the rival contentions extracted above, the first question that arises for consideration is as to whether the High Court ought to interfere, Under Article 226/227 of the Constitution, with an order passed by NCLT in a proceeding under the IBC, 2016, despite the availability of a statutory alternative remedy of appeal to NCLAT.

27. Though in ***Thressiamma Jacob v. Deptt. of Mining & Geology***, (2013) 9 SCC 725 this Court held that the mineral wealth in the subsoil would go along with the ownership of the land, the question of entitlement of the government to charge royalty was left open, as it was pending reference to the constitution bench. But in the case on hand, the land which formed the subject matter of mining lease, belongs to the State of Karnataka. The liberties and

privileges granted to the Corporate Debtor by the Government of Karnataka under the mining lease, are delineated in Part IV of the mining lease. The mining lease was issued in accordance with the statutory Rules namely Mineral Concession Rules, 1960. Therefore the relationship between the Corporate Debtor and the Government of Karnataka under the mining lease is not just contractual but also statutorily governed. As we have indicated elsewhere, the MMDR Act, 1957 is a Parliamentary enactment traceable to Entry 54 in List I of the Seventh Schedule. This Entry 54 speaks about Regulation of mines and development of minerals to the extent to which such Regulation and development under the control of the Union, is declared by Parliament by law to be expedient in public interest. In fact ***the expression "public interest" is used only in 3 out of 97 Entries in List I, one of which is Entry 54, the other two being Entries 52 and 56***. Interestingly, Entry 23 in List II does not use the expression "public interest", though it also deals with Regulation of mines and mineral development, subject to the provisions of List I. It is this element of "public interest" that finds a place in Section 2 of the MMDR Act, 1957, in the form of a declaration. Section 2 of MMDR Act, 1957 reads as follows:

> *It is hereby declared that it is expedient in the public interest that Union should take under its control the Regulation of mines and the development of minerals to the extent hereinafter provided.*

28. Therefore as rightly contended by the learned Attorney General, the decision of the Government of Karnataka to refuse the benefit of deemed extension of lease, is in the public law domain and hence the correctness of the said decision can be called into question only in a superior court which is vested with the power of judicial review over administrative action. The NCLT, being a creature of a special statute to discharge certain specific functions, cannot be elevated to the status of a superior court having the power of judicial review over administrative action. Judicial review, as observed by this Court in **Sub-Committee on Judicial Accountability v. Union of India,** (1991) 4 SCC 699 flows from the concept of a higher law, namely the Constitution. Paragraph 61 of the said decision captures this position as follows:

> *But where, as in this country and unlike in England, there is a written Constitution which constitutes the fundamental and in that sense a "higher law" and acts as a limitation upon the legislature and other organs of the State as grantees under the Constitution, the usual incidents of parliamentary sovereignty do not obtain and the concept is one of 'limited government'. Judicial review is, indeed, an incident of and flows from this concept of the fundamental and the higher law being the touchstone of the limits of the powers of the various organs of the State which derive power and authority under the Constitution and that the judicial wing is the interpreter of the Constitution and, therefore, of the limits of authority of the different organs of the State. It is to be noted that the British Parliament with the Crown is supreme and its powers are unlimited and courts have no power of judicial review of legislation.*

29. The NCLT is not even a Civil Court, which has jurisdiction by virtue of Section 9 of the Code of Civil Procedure to try all suits of a civil nature excepting suits, of which their

cognizance is either expressly or impliedly barred. Therefore NCLT can exercise only such powers within the contours of jurisdiction as prescribed by the statute, the law in respect of which, it is called upon to administer. Hence, let us now see the jurisdiction and powers conferred upon NCLT.

30. NCLT and NCLAT are constituted, not under the IBC, 2016 but Under Sections 408 and 410 of the Companies Act, 2013. Without specifically defining the powers and functions of the NCLT, Section 408 of the Companies Act, 2013 simply states that the Central Government shall constitute a National Company Law Tribunal, to exercise and discharge such powers and functions as are or may be, conferred on it by or under the Companies Act or any other law for the time being in force. Insofar as NCLAT is concerned, Section 410 of the Companies Act merely states that the Central Government shall constitute an Appellate Tribunal for hearing appeals against the Orders of the Tribunal. The matters that fall within the jurisdiction of the NCLT, under the Companies Act, 2013, lie scattered all over the Companies Act. Therefore, Sections 420 and 424 of the Companies Act, 2013 indicate in broad terms, merely the procedure to be followed by the NCLT and NCLAT before passing orders. However, there are no separate provisions in the Companies Act, exclusively dealing with the jurisdiction and powers of NCLT.

36. From a combined reading of Sub-section (4) and Sub-section (2) of Section 60 with Section 179, it is clear that none of them hold the key to the question as to whether NCLT would have jurisdiction over a decision taken by the government under the provisions of MMDR Act, 1957 and the Rules issued there-under. The only provision which can probably throw light on this question would be Sub-section (5) of Section 60, as it speaks about the jurisdiction of the NCLT. Clause (c) of Subsection (5) of Section 60 is very broad in its sweep, in that it speaks about any question of law or fact, arising out of or in relation to insolvency resolution. But a decision taken by the government or a statutory authority in relation to a matter which is in the realm of public law, cannot, by any stretch of imagination, be brought within the fold of the phrase "***arising out of or in relation to the insolvency resolution***" appearing in Clause (c) of Sub-section (5). Let us take for instance a case where a corporate debtor had suffered an order at the hands of the Income Tax Appellate Tribunal, at the time of initiation of CIRP. If Section 60(5)(c) of IBC is interpreted to include all questions of law or facts under the sky, an Interim Resolution Professional/Resolution Professional will then claim a right to challenge the order of the Income Tax Appellate Tribunal before the NCLT, instead of moving a statutory appeal Under Section 260A of the Income Tax Act, 1961. Therefore the jurisdiction of the NCLT delineated in Section 60(5) cannot be stretched so far as to bring absurd results. (It will be a different matter, if proceedings under statutes like Income Tax Act had attained finality, fastening a liability upon the corporate debtor, since, in such cases, the dues payable to the Government would come within the meaning of the expression "*operational debt*" Under Section 5(21), making the Government an "*operational creditor*" in terms of Section 5(20). The moment the dues to the Government are crystalised and what remains is only payment, the claim of the Government will have to be adjudicated and paid only in a manner prescribed in the resolution plan as approved by the Adjudicating Authority, namely the NCLT.)

39. If NCLT has been conferred with jurisdiction to decide all types of claims to property, of the corporate debtor, Section 18(f)(vi) would not have made the task of the interim resolution professional in taking control and custody of an asset over which the corporate debtor has ownership rights, ***subject to the determination of ownership by a court or other authority***. In fact an asset owned by a third party, but which is in the possession of the corporate debtor under contractual arrangements, is specifically kept out of the definition of the term "assets" under the Explanation to Section 18. This assumes significance in view of the language used in Sections 18 and 25 in contrast to the language employed in Section 20. Section 18 speaks about the duties of the interim resolution professional and Section 25 speaks about the duties of resolution professional. These two provisions use the word "assets", while Section 20(1) uses the word "property" together with the word "value". Sections 18 and 25 do not use the expression "property". Another important aspect is that Under Section 25(2)(b) of IBC, 2016, the resolution professional is obliged to represent and act on behalf of the corporate debtor with third parties and exercise rights for the benefit of the corporate debtor in ***judicial, quasi-judicial and arbitration proceedings***. Section 25(1) and 25(2)(b) reads as follows:

> ***25. Duties of resolution professional -***
>
> *(1) It shall be the duty of the resolution professional to preserve and protect the assets of the corporate debtor, including the continued business operations of the corporate debtor.*
>
> *(2) For the purposes of Sub-section (1), the resolution professional shall undertake the following actions:*
>
> *(a).....*
>
> *(b) represent and act on behalf of the corporate debtor with third parties, exercise rights for the benefit of the corporate debtor in judicial, quasi judicial and arbitration proceedings.*

This shows that wherever the corporate debtor has to exercise rights in judicial, quasi-judicial proceedings, the resolution professional cannot short-circuit the same and bring a claim before NCLT taking advantage of Section 60(5).

40. Therefore in the light of the statutory scheme as culled out from various provisions of the IBC, 2016 it is clear that wherever the corporate debtor has to exercise a right that falls outside the purview of the IBC, 2016 especially in the realm of the public law, they cannot, through the resolution professional, take a bypass and go before NCLT for the enforcement of such a right.

45. Therefore, in fine, our answer to the first question would be that NCLT did not have jurisdiction to entertain an application against the Government of Karnataka for a direction to execute Supplemental Lease Deeds for the extension of the mining lease. Since NCLT chose to exercise a jurisdiction not vested in it in law, the High Court of Karnataka was justified in entertaining the writ petition, on the basis that NCLT was *coram non judice*.

46. The second question that arises for our consideration is as to whether NCLT is competent to enquire into allegations of fraud, especially in the matter of the very initiation of CIRP.

48. In the light of the above averments, the Government of Karnataka thought fit to invoke the jurisdiction of the High Court Under Article 226 without taking recourse to the statutory alternative remedy of appeal before the NCLAT. But the contention of the Appellants herein is that allegations of fraud and collusion can also be inquired into by NCLT and NCLAT and that therefore the Government could not have bypassed the statutory remedy.

49. The objection of the Appellants in this regard is well founded. Section 65 specifically deals with fraudulent or malicious initiation of proceedings. It reads as follows:

> *65.* ***Fraudulent or malicious initiation of proceedings****. - (1) If, any person initiates the insolvency resolution process or liquidation proceedings fraudulently or with malicious intent for any purpose other than for the resolution of insolvency or liquidation, as the case may be, the adjudicating authority may impose upon such person a penalty which shall not be less than one lakh rupees, but may extend to one crore rupees.*
>
> *(2) If, any person initiates voluntary liquidation proceedings with the intent to defraud any person the adjudicating authority may impose upon such person a penalty which shall not be less than one lakh rupees but may extend to one crore rupees.*

50. Even fraudulent tradings carried on by the Corporate Debtor during the insolvency resolution, can be inquired into by the Adjudicating Authority under Section 66. Section 69 makes an officer of the corporate debtor and the corporate debtor liable for punishment, for carrying on transactions with a view to defraud creditors. Therefore, NCLT is vested with the power to inquire into (i) fraudulent initiation of proceedings as well as (ii) fraudulent transactions. It is significant to note that Section 65(1) deals with a situation where CIRP is initiated fraudulently "***for any purpose other than for the resolution of insolvency or liquidation***".

51. Therefore, if, as contended by the Government of Karnataka, the CIRP had been initiated by one and the same person taking different avatars, not for the genuine purpose of resolution of insolvency or liquidation, but for the collateral purpose of cornering the mine and the mining lease, the same would fall squarely within the mischief addressed by Section 65(1). Therefore, it is clear that NCLT has jurisdiction to enquire into allegations of fraud. As a corollary, NCLAT will also have jurisdiction. Hence, fraudulent initiation of CIRP cannot be a ground to bypass the alternative remedy of appeal provided in Section 61.

52. The upshot of the above discussion is that though NCLT and NCLAT would have jurisdiction to enquire into questions of fraud, they would not have jurisdiction to adjudicate upon disputes such as those arising under MMDR Act, 1957 and the Rules issued thereunder, especially when the disputes revolve around decisions of statutory or quasi-judicial authorities, which can be corrected only by way of judicial review of administrative action.

Hence, the High Court was justified in entertaining the writ petition and we see no reason to interfere with the decision of the High Court. Therefore, the appeals are dismissed. There will be no order as to costs.

T H E E N D