

PETITIONER:
BAJAJ AUTO LTD.

Vs.

RESPONDENT:
N. K. FIRODIA & ANR. ETC.

DATE OF JUDGMENT:
04/09/1970

BENCH:
RAY, A.N.
BENCH:
RAY, A.N.
HIDAYATULLAH, M. (CJ)
MITTER, G.K.

CITATION:
1971 AIR 321 1971 SCR (2) 40
1970 SCC (2) 550
CITATOR INFO :
RF 1986 SC1370 (54,83)

ACT:
Companies Act, 1956 s. 111(3), s. 111(5A)-Appeal against refusal to transfer shares-Scope of-Directors power to refuse transfers Circumstances when such refusal cannot be upheld.

HEADNOTE:

A group of shareholders led by applied to have transfers of certain shares of the appellant company registered in their names but the Directors refused to register the transfers. In the course of an appeal by the F group of respondents to the Company Law Board against the refusal, and upon being asked by that Board to disclose the reasons for the refusal, the appellant company gave three reasons : First, that F, who was the company's Chief Executive had written to the Company Law Board against the extension of the term of the company's managing agents and had thus acted in a treacherous fashion against the interest of the company; it was therefore evident that F's design was to create mischief; secondly, the transfer of shares applied for was part of a design of the F group to acquire interest in the company which was likely to result in a threat to the smooth functioning of the management of the company, and to vote down the passing of any special resolution required for the management of the company; thirdly, the purchase of shares by the F group was not with a view to a bona fide investment but was with a mala fide purpose and evil design. The Company Law Board allowed the appeal and directed the appellant company to register the transfer of the shares. On appeal to this Court,

HELD, dismissing the appeal : (i) in refusing to register the transfers, the Directors did not act bona fide nor did they act in the general interest of the company. On the contrary, they acted upon a wrong principle and for the oblique motive of squeezing out F. On the facts, the inescapable conclusion was that the Directors acted arbitrarily and with the collateral and corrupt motive of keeping their own group in control of the company.

It was apparent that F. wrote to the Company Law Board against the appointment of the Managing Agents in the larger interest of the company. He was justified in opposing their re-appointment without a specific resolution of the shareholders of the company and without a public notice to the shareholders to represent their views in the matter.

There are well recognised safeguards as to notice and consent for passing a special resolution. Special resolutions are for limited purpose, and are not matters of daily occurrence or of daily routine administration. The mere apprehension that special resolutions will not be passed was not a legitimate reason.

There was no evidence that the transferees belonged to a rival concern. Equally, there was no evidence that the F group ever obstructed

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in the management of the company. On the contrary they advanced large sums of money and F was largely responsible for the gradual growth and prosperity of the company. It was therefore an abuse of the fiduciary power of the Directors to refuse to register the transfers of the shares.

[53 D; 54 D]

(ii) Although the company's Articles of Association provided that the Directors might at their absolute and uncontrolled discretion decline to register any transfer of shares, such discretion does not mean a bare affirmation or negation of a proposal. Discretion implies just and proper consideration of the proposal in the facts and circumstances of the case. In the exercise of that discretion the Directors will act for the paramount interest of the company and for the general interest of the shareholders because the Directors are in a fiduciary position both towards the company and towards every shareholder. The Directors are therefore required to act bona fide and not arbitrarily and not for any collateral motive. [46 C]

(iii) If the Articles permit the Directors to decline to register transfer of shares without stating the reasons, the Court would not draw un-favourable inferences against the Directors because they did not give reasons. Where however the Directors give reasons the Court would consider whether they were legitimate and whether the Directors proceeded on a right or wrong principle. As a result of the introduction of section 111(5A) in the Companies Act, 1956, two consequences follow. First, if the Articles permit the Directors not to disclose reasons for declining to register a transfer, the statute confers power to interrogate the Directors and disclose the reasons. Secondly, if the Directors do not disclose reasons, presumption can be drawn against the Directors for non-disclosure of reasons in spite of being called upon to do so. [46 D]

M/s Harinagar Sugar Mills Ltd. v. Shyam Sunder Jhunghunwala
JUDGMENT:

Ltd., [1950] 2.A.E.R. 1120; Ex-parte Penney, L.R. 8 Ch. 446, Re. Bede Steam Shipping Company Ltd., (1917) 1 Ch. 123; Re. Bell Brothers Ltd., 7 Times Law Reports 689; Pender v. Lushington, L.R. 6 Ch. D. 70; Balwant Transport Co. Ltd. Amraoti v. Y. H. Deshpande, A.I.R. 1950 Nag. 20; Re. Smith & Fawcett Ltd., [1942] Ch. 304; Kaikhosro Muncherji Heera 'Maneck & Ors. v. The Coorla Spinning & Weaving Company & Ors, I.L.R. 16 Bom. 80 and The Muir Mills Company Ltd. of Cawnpore v. T. H. Condon & Anr., I.L.R. 22 All. 410; referred to.,

&
CIVIL APPELLATE JURISDICTION Civil Appeals Nos. 546, 547 and 692 to 1031 of 1970.

Appeals by special leave from the orders dated March 14, 1970 of the Company Law Board, Department of Company Affairs, Ministry of Industrial Development, Internal Trade & Company Affairs, New Delhi in Appeals Nos. 4 to 7 of 1969 etc.

C. K. Daphtary, A. K. Sen. L. M. Singhvi, S. Swarup, B. Datta, J. B. Dadachanji, O. C. Mathur 'and Ravinder Narain, for the appellant (in all the appeals).

F. S. Nariman, A. B. Diwan, K. J. Merchant and I. N. Shroff, for respondent No. 1 (in all the appeals).

Sup.CI/71-4

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The Judgment of the Court. was delivered by Ray, J. These appeals are by special leave against the order dated 14 March, 1970 made by the Company Law Board, Department of Company Affairs, Ministry, of Industrial Development, Internal Trade and Company Affairs, New Delhi, under section 111(3) of the Companies Act, 1956 directing the appellant company to register transfer of 3643 shares forming the subject matter of these appeals.

The respondents in these appeals are Jaya Hind Industries Ltd. N. K. Firodia and other persons who will be referred to as the Firodia group. The appellant will be referred to as the Bajaj group.

The Firodia group lodged in different lots 3643 shares of the appellant for being transferred to different names. Jaya Hind Industries Private Ltd. applied for transfer of 1500 shares in their names. Firodia applied for transfer of 30 shares in his name. The other transfers were in the names of associates, nominees and friends of the Firodia group. The Board of the appellant refused to register transfer of the said shares at the Board meetings held on 23 May, 1968 in respect of 2532 shares and on 24 June, 1968 in respect of 1111 shares. The appellant communicated the said refusal to transfer the shares in the month of June, 1968.

Thereafter, in the month of August, 1968 338 appeals were filed before the Company Law Board in respect of refusal of the appellant to transfer 3643 shares. The Company Law Board by its letter dated 16 January, 1969 asked the appellant to disclose the reasons for refusal to register transfer of shares. The appellant company gave three reasons for refusal to register transfer of the said 3643 shares. First, that Jaya Hind Industries Private Ltd. was a beneficiary to the extent of 1/4 share in the Managing Agency remuneration receivable by Jamnalal Sons Private Ltd. from Bajaj Auto Ltd. and yet N. K. Firodia chose to write to the Company Law Board against., the extension of the Managing Agency of Jamnalal Sons Private Ltd. The company further said that N. K. Firodia, according to the appellant company, was their representative and when N. K. Firodia acted in such a treacherous fashion and against the interest of the company and behind the back of the Board of Directors it became evident that Firodia's design was to create mischief. Secondly, the transfer of shares received from Jaya Hind Industries Private Ltd. was part of the design to acquire interest in the company which was likely to result in a threat to the smooth functioning of the management of the company, and to vote down the passing of a special resolution required for the management of the company, and, therefore,

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transfer should not be permitted. Thirdly, the purchase of

shares by Jaya Hind Industries Private Ltd. was not with a view to bona fide investment but was with a mala fide purpose and evil design. It was said that the issued share capital of the company was 1,04,250 shares of Rs. 100 each. Firodia group was holding 21,500 shares. Transferring further shares to the names of Firodia group would obstruct the business of the appellant company in the passing of special resolution which was required in the day to day business of the company. It was also said that from the investment point of view with a dividend of Rs. 10 per share on a paid up share of Rs. 100 the purchase price paid by Firodia group was artificial and could only be with a view to try to take control and/or obstruct the business and smooth working of the company and to injure the existing management. The appellant company concluded by saying that the Board of Directors came to the conclusion that it was in the interest of the company to refuse the said transfers.

In order to appreciate whether the Directors used the discretion in proper exercise of their fiduciary power and the reasons were bona fide and legitimate in the interest of the company as a whole, it is necessary to refer to certain features of the case.

In the year 1947 a joint venture business was entered into between Jaya Hind Industries Ltd. and Bachhraj Trading Corporation Ltd. In the month of March, 1950, Bachhraj Trading Corporation suffered heavy losses and the joint venture was transferred to Bajaj Factories Ltd. with the consent of Jaya Hind Industries Ltd.

In the year 1952 N. K. Firodia became a Director of Bachhraj Trading Corporation Ltd. In the month of April, 1954 Jaya Hind Industries Ltd. acquired 1800 shares of the face value of Rs. 1,80,000 of Bachhraj Trading Corporation Ltd. at Rs. 36/8/per share which together with 50 shares held by N. K. Firodia equalled 3/8ths of the share capital. In the month of May, 1954, Bachhraj Trading Corporation Ltd. again took over the business of the joint venture from Bajaj Factories Ltd. In the year 1955 N. K. Firodia as a Director of Bachhraj Trading Corporation Ltd. applied to the Central Government for the manufacturing licence of scooters, auto rickshaws and tempo three wheeler vehicles. In the year 1957 Bachhraj Trading Corporation Ltd. was granted the manufacturing licence of tempo three wheelers. In 1958 Bajaj Tempo Private Ltd. was formed to manufacture tempo three wheeler vehicles and N. K. Firodia was appointed the Managing Director of the same. In the year 1959 Bachhraj Trading Corporation Ltd. was granted licence to manufacture scooters and auto rickshaws. In the year 1960 the name of

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Bachhraj Trading Corporation Ltd. was changed to Bajaj Auto Private Ltd. Shares of Bajaj Auto Private Ltd. were offered to shareholders of Bachhraj Trading Corporation in proportion to, their shareholding.

Between the years 1954 and 1960 Jaya Hind Industries Private Ltd. of the Firodia group had provided substantial funds amounting to Rs. 4,36,000 to the appellant company in its former name. In the year 1960 there was a Managing Agency agreement between the appellant company and Jamnalal Sons Private Ltd. for a period of five years. In 1960 when the appellant was converted into a public limited company and Firodia was appointed as its Chief Executive, the respondent company of the Firodia group by themselves, their shareholders and friends subscribed for 37-1/2% of the shares offered to the then existing shareholders of the appellant company. An agreement was entered into between Jamnalal Sons Private Ltd. Managing Agents of the appellant company

and the respondent Jaya Hind Industries Private Ltd. on 15 August, 1960 by which the Managing Agents agreed to pay 25% of the remuneration of the Managing Agency to the respondent company in consideration of services rendered to the appellant company. Gradually, the appellant company grew into a prosperous and very well developed automobile unit. Land was acquired, buildings were constructed and machinery and equipment worth more than a crore of rupees was purchased and installed. The manufacturing activity of the appellant company made good progress and 90% of the components of scooters and auto rickshaws were capable of being manufactured indigenously.

In the month of June, 1965 the appellant company applied to the Central Government for re-appointment of Jamnalal Sons Private Ltd. as Managing Agents of the appellant company for a period of 10 years. The Central Government on 11 August, 1965 sanctioned the said re-appointment of Managing Agents for the period commencing 16 August, 1965 and ending 31 March, 1968, viz., for an approximate period of three years. The appellant company entered into an agreement with the Managing Agents on similar terms.

In the month of August, 1967 Kamalnayan Bajaj of the Bajaj group proposed at the Board meeting of the appellant that an application should be made to extend the term of the Managing Agency. Firodia of the respondent company group opposed any such extension. In the month of December, 1967 the appellant applied to the Company Law Board for extension of the term of Managing Agency of Jamnalal Sons Private Ltd. for a period of 7 years so that the Managing Agents would have a term of 10 years commencing 16 August, 1965. The letter of the appellant

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company was signed by the Secretary. In the month of March, 1968 Firodia came to know about the said letter and wrote to the Chairman of the Company Law Board that there was neither any resolution of the general meeting of the company for such extension nor any publication of such appointment. Firodia said that the appellant company contravened, in particular, the provisions contained in sections 326 and 640B of the Companies Act, 1956. The Company Law Board, however, approved of the extension of the Managing Agency for a period of two years from 31 March, 1970.

The appellant company was converted into a public limited company in 1960 and the share capital was increased from Rs. 9,90,000 to Rs. 70,00,000. In the month of February and March, 1967 the capital of the appellant company was increased by issue of right shares. By the end of February, 1968 out of the issued share capital of 1,04,250 shares the Bajaj group held about 28,600 shares the Firodia group 23,400 shares and the general public about 52,250 shares. The Bajaj group however alleged that in February, 1968 they held 31,500 shares and the Firodia group had 21,735 shares. In the month of March, 1968 the Bajaj group bought about 16,230 shares up to the maximum value of Rs. 411 per share. It may be mentioned here that out of the said 16,230 shares the Bajaj group bought about 4,000 shares from the Life Insurance Corporation Ltd. and the Unit Trust of India. The Bajaj group obtained transfer of the said 16,230 shares in their names. The Firodia group, on the other hand, from the month of April, 1968 onwards lodged in different lots 3,643 shares of the appellant company for being transferred to their names. The Board declined to register any transfer in respect of the said 3,643 shares.

It is also necessary to know about the antecedents and

activities of Firodia in relation to the affairs of the appellant company. When the joint venture was started in the year 1946 between Bachhraj Trading Corporation Ltd. and the respondent company Firodia was in actual charge of the joint venture. In the year 1950 Firodia went to Germany and obtained representation from Vidal and Sohn Tempo Works Hamburg, Germany in connection with the manufacture of tempo three wheeler vehicles. In 1952 Firodia became a Director of Bachhraj Trading Corporation Ltd. Firodia thereafter submitted a scheme for the manufacture of scooters and auto rickshaws and obtained a licence for Bachhraj Trading Corporation Ltd. in that behalf. The Firodia group acquired shares of the face value of Rs. 1,80,000 in Bachhraj Trading Corporation in the year 1954 and helped its rehabilitation after it suffered heavy losses. The Firodia group provided funds to the extent of Rs. 4,36,000 to the Bajaj group during the years 1954 and 1960.

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When the appellant company became a public limited company in the year 1960 the Firodia group subscribed for 371% of the shares and assisted in procuring subscription to the shares offered to the public. Jammalal Sons Private Ltd. the Managing Agents of the appellant agreed to pay 25% of their remuneration of the Managing Agency to the respondent company of the Firodia group in consideration of the services rendered.

Article 52 of the appellant company provided that the Directors might at their absolute and uncontrolled discretion decline to register any transfer of shares. Discretion does not mean a bare affirmation or negation of a proposal. Discretion implies just and proper consideration of the proposal in the facts and circumstances of the case. In the exercise of that discretion the Directors will act for the paramount interest of the company and for the general interest of the shareholders because the Directors are in a fiduciary position both towards the company and towards every shareholder. The Directors are therefore required to act bona fide and not arbitrarily and not for any collateral motive.

If the, Articles permit the Directors to decline to register transfer of shares without stating the reasons the Court would not draw unfavourable inferences against the Directors because they did not give reasons. In other words, the court will assume that the Directors acted reasonably and bona fide and those who allege to the contrary would have to prove and establish the same by evidence. Where however the Directors gave reasons the Court would consider whether they were legitimate and whether the Directors proceeded on a right or wrong principle. As a result of the introduction of section 111(5A) in the Companies Act, 1956 two consequences follow. First, if the Articles permit the Directors not to disclose reasons for declining to register a transfer the statute confers power to interrogate the Directors and disclose the reasons. Secondly, if the Directors do not disclose reasons presumption can be drawn against the Directors for non-disclosure of reasons in spite of being called upon to do so.

In the present appeals, the reasons of the Directors have to be tested from three points of view. First, whether the Directors acted in the interest of the company; secondly, whether they acted on a wrong principle; and, thirdly, whether they acted with an oblique motive or for a collateral purpose. This Court in M/s Harinagar Sugar Mills Ltd. v. Shyam Sundar Jhunihunwala & Ors(1) said that "the discretion of the Directors would be nullified if it were

established that the Directors acted oppressively, capriciously or corruptly or in some other way mala fide". The decision in Harinagar Sugar Mills Ltd.(2) related to a case under the Com-

(1) [1962] 2 S.C.R. 339.

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panies Act, 1956 prior to the introduction of section 111(5A). That is why if the Directors under the Articles were not to disclose reasons it was said that the Court would presume where the Directors refused to register the transfer of shares that their power of absolute discretion was exercised bona fide unless corrupt or mala fide motives were affirmatively pleaded and proved. It would be for the aggrieved transferor to show that the refusal to register transfer was exercised mala fide and not in the interest of the company and thereby the presumption of bona fide would be displaced.

The words 'bonafide and for the benefit of the company as a whole' have been considered in some English decisions. Reference may be made to the decision in Greenhalgh v. Arderne Cinemas Ltd.(1) where Evershed, M.R. said that if a resolution had the effect "to discriminate 'between the majority shareholders and the minority shareholders so as to give the former advantage of which the later were deprived", the resolution could be attacked on grounds of elements of dishonesty or impropriety. The acts of the Directors would have to be scrutinised as to whether they were the honest opinion of the Directors acting for the company as a whole. Mellish, L.J. in Ex-parte Penney(1) said that the Directors would have no right to force a particular shareholder to continue as a shareholder and not, to allow him to transfer shares at all because that would be an abuse of their power. Lord Cozens-Hardy, M.R. in Re. Bede Steam Shipping Company Ltd.(2) said that the personal objections to a transferee were where the transferee would be a quarrelsome person or he would be an unreasonable person or he would be acting in the interest of a rival company. The Directors there had power to refuse to register transfer of shares if "in their opinion it is contrary to the interest of the company that the proposed transferee should be a member thereof". In that case there were disputes between the Elder brothers who were Directors. One of the Elder Brothers sold his two shares to a clerk of his and another share to his house-keeper. The other Director said that the company was really a family concern and therefore the shares should not be transferred singly or in small lots to outside persons having no interest in, or knowledge, of shipping. In Bede Steam Shipping Co. (3) the power of the Directors was to refuse to register the transfer of share to any person of whom the Directors did not approve as transferee. The Directors in declining to register the transfer gave two reasons. First, that there would be increase in expenditure if the body of shareholders who numerically increased and secondly the individuals, who were neither related to the founders family nor connected in

(1) [1950] 2 A.E.R. 1120.

(2) L.R. 8 Ch. 446.

(3) [1917] 1 Ch. 123.

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business with the company would become members by the proposed transfer. Neither of these reasons was held to touch the fitness of the transferees. The real power of the Directors in refusing registration of transfer was on the ground of personal objections to the transferees. The apprehension on the part of the Directors in the increase in the number of shareholders was therefore found to be an

abuse of power. It was found that the Directors in refusing registration to transfer thought of the proposed transferees as mere nominees who could adopt the attitude of the transferor who had disagreed with the Directors of the company. The Directors did not look at the relevant circumstances in which they were placed, namely, their status, their occupation, and, in particular, whether the transferees were interested in any private business competing with the company.

Reference may be made to an old decision in *Re. Bell Brothers Ltd.*(1) as an illustration of the power of the Directors to refuse registration of transfer. The relevant Article in the case of *Bell Brothers*(2) conferred discretionary power on the Directors to refuse registration of transfer of shares on the ground that the Directors did not approve of the transferee. Chitty, J. said in relation to the Directors' power that the Directors must act in good faith and in the interest of the company and with due regard to the right of a shareholder to transfer his shares and they must fairly consider the question of the transferee's fitness at a card meeting. The Directors in that case were not required to disclose reasons. Three propositions can be extracted from that case. First, where the Directors do not assign any reason because of the Articles it is competent for those who seek to have the transfer registered to show affirmatively by proper evidence that the Directors had not duly exercised their power. Secondly, if reasons are given by the Directors and the reasons are legitimate the court will not overrule the Directors decision merely because the court itself would not have come to the same conclusion. Thirdly, if the reasons are not legitimate, the court would hold that the power had not been duly exercised. An example would be where the Directors said that they rejected the transfer because the transferor's object was to increase the voting power in respect of his shares by splitting them among his nominees.

In the case of *Bell Brothers*(1) two Bell brothers John and Lowthian and the members of their families were shareholders in *Bell Brothers*. John died leaving a will and the beneficiaries under the will were his widow and children. The will provided for the widow an annuity. The will contained a general trust for conversion. John's shares were sold to provide a fund to meet

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the annuity. Hodgson purchased those shares. The Directors were Lowthian, his son Hugh and his son-in-law. High was an executor trustee under the will of John and as such was one of the transferors of the shares of John. The shares of the testator were in the names of Hugh, the nephew and Charles, the son of the testator as executor trustees. The shares being registered in two names, Hugh as the first on the register had the right to vote. Hugh had on the one hand expressed the opinion to sell the shares in the true interest of the beneficiaries and on the other hand as a Director opposed the sale to Hodgson on the ground that the shares should be held by the members of the Bell family. The Directors did not allow registration either in the name of Hodgson or his nominees.

It has been well-settled since the decision in *Pender v. Lushington*(1) that the Directors are not entitled to look behind the register to.- any purpose. They do not take notice of trust. Similarly, they cannot say that the transferee is the nominee of some one whom they consider objectionable. The accent is always on personal objections to the transferee. The solicitors of the Directors in the

case of Bell Brothers gave the real reason for refusal of registration that Hodgson was holder of shares in a rival company. Chitty, J. said that the Directors carefully abstained from stating what their personal objection to Hodgson was and put forward their solicitors to assign the reason for it. The Directors who had an opportunity of exercising their power attempted to exercise it upon a wrong principle and therefore their power was gone. It is quite likely that if the Directors had given evidence of their real reason the Court might have accepted it as legitimate. The decision in the case of Bell Brothers (2) illustrates that where the Directors have the power to refuse registration of the transfer of shares, their exercise of power on a wrong principle will vitiate the exercise of the power.

It follows that where the Directors have uncontrolled and absolute discretion in regard to declining registration of transfer of shares, the Court will consider if the reasons are legitimate or the Directors have acted on a wrong principle or from corrupt motive. If the Court found that the Directors gave reasons which were legitimate, the Court would not overrule that decision merely on the ground that the Court would not have come to the same conclusion. Reference may be made to the decision in Balwant Transport Co. Ltd. Amraoti v. Y. H. Deshpande(3) which is a Bench decision of the Nagpur High Court. Sapate was a shareholder in the company and owned 31 shares. One of his shares was sold by public auction and was purchased by Deshpande. Deshpande applied for registration. The Article in the Nagpur case conferred

(1) L.R. 6 Ch. D. 70.

(2) 7 Times Law

Reports 689

(3) A.I.R. 1950 Nag. 20.

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absolute and uncontrolled discretion on the Directors to refuse to register transfer where in the opinion of the Directors it was not in the interest of the company to admit the proposed transferee to membership. The evidence in that case was that Deshpande was the lawyer of Sapate. Sapate was quarrelling with the company. Sapate also joined a rival concern. The Directors decision in those surrounding circumstances was found to be a legitimate exercise of the power of the Directors in the interest of the company. The decision in Re. Smith & Fawcett Ltd. (1) indicates the extent to which the court upholds the exercise of absolute and uncontrolled discretion of the Directors to refuse to register any transfer of shares. In that case there were two Directors who held the shares in equal numbers. One died. The other Director refused to register the transfer of shares in the names of the executors of the deceased Director except in respect of a part of the holding and upon the condition that the balance be transferred to the surviving Director. It was found to be a justifiable act of the Director in the interest of the company.

In the old Bombay decision in Kaikhosro Muncherji Heera 'Maneck & Ors. v. The Coorla Spinning & Weaving Company & Ors(1) the Board of Directors might decline to register any transfer of shares, unless the transferees were approved by the Board. A shareholder became insolvent. His share vested in the Official Assignee. The Official Assignee sold the shares. The purchaser applied for registration. The Directors declined to approve of the transferees unless the transferees would pledge themselves not to oppose a certain change in the mode of remunerating the Agents of the company, which the Directors desired to effect, and which

they believed would be very advantageous to the company. It may be mentioned here that the purchaser of the shares required the Official Assignee to register transfer in the names of the two nominees who were already the holders of shares in the company. The company, however, did not take any objection to the nominees in their personal capacity. The Directors acted on wrong principle and in abuse of power in insisting on obtaining a pledge from the transferees not to oppose change in remuneration of the Managing Agents.

A Bench decision of the Allahabad High Court in *The Muir Mills Company Ltd. of Cawnpore v. T. H. Condon & Anr.* (3) related to the absolute power of the Directors to refuse registration of transfer of shares on personal objections to the transferee. The *Muir Mills* in that case disallowed the transfers on the ground that the transferees were subordinates of McRobert, the Managing

(1) 19 42 Ch. 304.

(3) I.L. R. 22 All. 410.

(2) I.L.R. 16 Bom 80.

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Director of Cawnpore Mills. There was personal animosity between Johnson, the Managing Director of the Muir Mills and McRobert. The Directors of the Muir Mills came to a conclusion that McRobert should not add to his voting power and 'harass the management'. It was found to be abuse of fiduciary discretionary power of the Directors when they wanted to safeguard the Directors personal interest against McRobert.

The first reason of the appellant company for the refusal of registration of transfer of the shares was that Firodia acted in a treacherous fashion against the interest of the company and behind the back of the Board of Directors. The evidence is that the Managing Agents of the Bajaj group in the year 1965 failed to obtain from the Government approval of an extension of term for 10 years. The Government sanctioned the term for about three years which was to expire on 31 March, 1968. In the month of August, 1967 when Kamalnayan Bajaj of the Bajaj group proposed an extension of the term of the Managing Agents Firodia represented to the Board that Firodia was opposed to the same. No application for extension of the term of Managing Agents was made at that time. The appellant however behind the back of Firodia wrote to the Company Law Board in the month of December, 1967 and though Firodia was the Chief Executive the letter was signed by the Secretary and kept concealed from Firodia. Firodia came to know of the letter, in the month of March, 1968 and he wrote to the Company Law Board that the company had made "false statement" in the application for extension of the term, namely, that the appellant company gave a wrong impression that it had received permission to increase its production to 60,000 scooters per year whereas in fact no such permission had been granted. Firodia also pointed out that the appellant suggested that its progress was because of the Bajaj group and made no reference to Firodia who was the Chief Executive of the appellant.

In 1965 the appellant asked for appointment of the Managing Agents for ten years. The Company Law Board approved of the appointment upto 31 March, 1968. It is true that there was a resolution of the appellant company in the year 1965 for the appointment of the Managing Agents for a period of ten years. That resolution of 1965 after the appointment of the Managing Agents for a term of less than three years and, in particular, after an agreement had been entered into between the appellant company on the one hand and the Managing Agents on the other in that behalf. was exhausted, and spent

its force and could not be said to have either a life of its own for 10 years or to spring into action in the year 1968 for a revival of the resolution to enable the appellant company to ask for appointment of Managing Agents for a period of seven years on the basis of any resolution. Firodia rightly

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protested against the absence of any resolution of the shareholders and also against the absence of any publication of proposal for appointment of Managing Agents for seven years. Firodia furthermore rightly cavilled against the total obscuration of his name or of any reference to his activities in relation to the affairs of the company and the contrary suggestion in the letter that the prosperity of the appellant company was an account of Kamalnayan Bajaj. This aspect is important to show that the allegations of Firodia were against the Managing Agents and further that Firodia was acting in the larger interest of the company whereas the Managing Agents were actuated by their personal motives of preservation and aggrandisement of their power. The letter written by the appellant to the Company Law Board was not circulated to the shareholders. Firodia came to know about the letter and that is why he informed the Company Law Board of the state of affairs.

On this evidence it is apparent that Firodia wrote to the Company Law Board in the larger interest of the company. Firodia's allegations were against the Managing Agents. Firodia was justified in opposing re-appointment of the Managing Agents without a specific resolution of the shareholders of the company and without a public notice to the shareholders to represent their views in the matter. The Bajaj group acted behind the back of Firodia and wanted to steal a march. The real motive of the Bajaj group was revealed first by imposing restrictions in the month of March, 1968 on the powers of Firodia as Chief Executive of the appellant, company and secondly by the resolution in the month of May, 1968 to terminate the services of Firodia as Chief Executive. The refusal to register the transfers was at the meetings of the Board held in the months of May and June, 1968.

The Directors had a hostile, feeling against Firodia and they had the dominant desire to keep Firodia out of the company. The Directors did not act in the interest of the company and their discretion was tainted by unfair conduct and unjustifiable attitude against Firodia.

The second reason given by the appellant company was that the Firodia group acquired the shares with a design of acquiring interest in the company which was likely to result in a threat to the smooth functioning of the management of the company and to vote down the passing of the special resolution. There are well recognised safeguards as to notice and content for passing special resolution. Special resolutions are for limited purposes and are not matters of daily occurrence or of daily routine administration. The mere apprehension that special resolutions will not be passed is not a legitimate reason. The shareholders will bestow their

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intention on matters forming the subject 'matter of resolution. Passing of special resolutions will depend upon the mandate of the shareholders. It is manifest that the reason given by the Directors was a camouflage to cover their collateral and corrupt motive of preserving the hegemony of the Bajaj group. The motive is corrupt because the Bajaj group acted for their personal interest and not in

the bonafide general interest of the company. The third reason given by the appellant company was that the shares were being acquired by the Firodia group not with a view of bonafide investment but with a malafide purpose and evil design of obstructing the business of the appellant company. Acquisition or transfer of shares under the Articles of the present case does not suffer from any restrictive impediment like pre-emption or personal objections to the transferees. There is no evidence that the transferees belonged to a rival concern. Equally, there is no evidence that the Firodia group ever obstructed in the management of the company. On the contrary, the Firodia group advanced large sums of money. Firodia was largely responsible for the gradual growth of the appellant company and for the prosperity of the company. It was therefore an abuse of the fiduciary power of the Directors to refuse to register transfer of shares. The Bajaj group obtained transfer of 16230 shares in their favour in the month of March, 1968. The Bajaj group purchased shares in the market at a maximum value of Rs. 411 per share. The holding of the Bajaj group prior to the acquisition of the said 16230 shares was 28600 shares or according to the Bajaj group 31,500 shares. The Firodia group on the other hand prior to the proposed transfer had 23,400 shares or 21,735 shares according to the Bajaj group. The general public held 52,250 shares. This was the position in the month of February, 1968. The Bajaj group by the acquisition of 16230 shares would have a numerical strength of 44830 shares whereas the Firodia group would be having 26863 shares if the proposed transfers were allowed by the Directors. The Bajaj group paid Rs. 411 per share. The Firodia group paid roughly about Rs. 200 per share. Firodia was not on the Board of Directors of the appellant company. The Bajaj group and their friends were the Directors. In the year 1967 the Firodia group lodged 4243 shares for transfer in their names and the transfers were registered. Again, in the month of February, 1968 when the Firodia group lodged 68 shares with the appellant company for transfer, the appellant company accepted the said transfer. It is, therefore, revealed that after the appellant came to know that Firodia wrote to the Company Law Board in the month of March, 1968 that the Directors of the appellant company developed antipathy against Firodia. The refusal to register the shares was a sequel to the termination of the appointment of Firodia as Chief

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reasons and in their own interest.

Counsel on behalf of the appellant contended that of the seven Directors only Kamalayan Bajaj belonged to the Bajaj family and each Director was an independent industrialist and could not be described to be of Bajaj group. Neither the status and wealth of the Directors nor their lack of relationship with the Bajaj family could be decisive as to whether they exercised their discretion on correct principle or without any corrupt motive. The Firodia group alleged that Kamalnayan Bajaj was an arbitrator in the family dispute of Ramnath A. Podar and that Shriyans Prasad Jain was a close associate of Kamalnayan Bajaj. Irrespective of these allegations, we have already indicated that the Directors failed to exercise their discretion properly by refusing to register transfer of shares on wrong principles and for corrupt and oblique motives.

The discretion of the Directors is to be tested as the opinion of fair and sensible men in the interest of the company. In the pro,-sent case, the Directors did not act

bonafide nor did they act in the general interest of the company. On the contrary, they acted upon a wrong principle and for the oblique motive of squeezing out Firodia. The inescapable conclusion is that the Directors acted arbitrarily and unjustifiably.

For these reasons we are of opinion that the appeals fail. They are dismissed with costs. The respondents will be allowed one set of hearing fees.

R.K.P.S.
dismissed.

Appeals

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JUDIS