Suit No. 285 *of* 1866.

THE EASTERN FINANCIAL ASSOCIATION (LIMITED)

v.

PESTANJI CURSETJI SHROFF.

Sale of Shares—fraud—illegal purpose—Articles of Association—option of shareholders—promissory note payable on demand—Schedule A, cl. 10 *of Stamp Act, No. X. of* 1862.

In a suit brought by a joint-stock company in liquidation against a former director of the company for Rs. 27,30,000, on a promissory note, dated the 1st of March, and purporting to be payable on demand, but with the words in pencil: "Due 4th June," put on it the same day it was signed, in accordance with an understanding between the defendant and the other directors that they would not press him for payment before the latter date, and signed by the defendant some days after the day it bore date:—*Held* that a one-anna stamp was not sufficient, under Schedule A, cl. 10 of Act. X. of 1862.

And, on the plaint being amended by claiming for the price of shares bargained and sold to the defendant, but not accepted by him; and for money found to be due on an account stated:—*Held* that the plaintiffs could not recover, 1st, because no shares were really bargained and sold as the plaint alleged; and what was done was, according to the intention and understanding of the parties, a mere form gone through, for the purpose of deceiving the public, and making it appear that 10,000 shares had been sold at a certain price; and, 2ndly, because the contracts were made for the purpose of defrauding other persons.

Held, also, that the 9th clause of the articles of association, providing that the existing shareholders for the time being should have the option of taking and subscribing for the shares in the additional capital, rateably and in proportion to their respective shares in the existing capital of the company, being imperative, and not merely directory, a deviation from it could not be made unless with the assent of every shareholder.

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THIS was a suit on defendant's promissory note for Rs. 27,30,000, being the aggregate price of 10,000 newly issued shares in the plaintiff's company, alleged to have been purchased by the defendant at a public auction; and also (after amendment) for the amount of the note and interest, as the price of shares bargained and sold to, but not accepted by, the defendant; and on an account stated.

The case was heard by COUCH, C. J., in a Division Court.

Howard and *Green* for the plaintiffs.

Scoble and *McCulloch* for the defendant.

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The facts (so far as material) are stated in the judgment.

In the course of the argument the following authorities were cited:—*Reg.* v. *Justices of Shropshire* (*a*); *In re The British Sugar Refining Co.* (*b*); *In re The Athenæum Life Insurance Society, Richmond's Case* (*c*); *In re The Magdalena Steam Nav. Co.* (*d*); *The Hull Flax and Cotton Mill Co.* v. *Wellesley* (*e*); *Bargate* v. *Shortridge* (*f*); Act XIX. of 1857, *passim*.

Cur. adv. vult.

December 1. COUCH, C. J.:—The plaint in this suit stated that the plaintiffs caused to be sold, by public auction, 12,500 shares, then newly issued, of the Eastern Financial Association (Limited); and the defendant at such sale became the purchaser of 10,000 of the said shares at different prices, amounting in the aggregate to Rs. 27,30,000, and on the terms that the defendant was to pay a deposit of Rs. 100 per share on the said shares at once, and the residue of the purchase-money within thirty days: that the defendant did not pay the deposit or any part of the purchase money; and to secure payment of the purchase-money he, on the 1st of March 1865, made his promissory note dated on that day, promising to pay to the plaintiffs on demand Rs. 27,30,000: that payment of that sum had been duly demanded, and the defendant had not paid it.

The defendant put in a written statement, in which he alleged that the sale by auction of the 12,500 shares was illegal and unauthorised by the articles of association of the company: that the sale was not intended to be, nor was it a *bonâ fide* sale; but was solely for the purpose of rigging the market, and unduly enhancing the price of shares in the company: that the plaintiffs were not ready and willing to deliver to him the 10,000 shares, or documents of title thereto: that the promissory note sued upon ought not to be received in evidence, inasmuch as it did not bear a sufficient stamp.

(*a*) 8 A. & E. 173. (*b*) 3 Kay & J. 408. (*c*) 4 Kay & J. 305.
(*d*) 29 Law J., N. S., Ch. 667. (*e*) 30 Law J., N. S., Ex. 5.
(*f*) 5 H. L. Ca. 297.

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The suit came on for hearing on the 16th of August last; and, in order to raise the question as to the sufficiency of the stamp, an issue was first recorded, whether the defendant made the promissory note mentioned in the plaint.

The note was produced and the signature proved to be the defendant's handwriting. It bore date the 1st of March 1865, and had on it a stamp of one anna, and it purported to be payable on demand, but above the date were in pencil the words "Due 4th June." The witness who proved the defendant's signature said the pencil note was put on it by one of the plaintiffs' clerks, and he had no doubt it was put at the time it was drawn; and (the plaintiffs' counsel not objecting to the admissibility of the evidence) he went on to say, that it was understood that the witness, who was the manager of the Eastern Financial Association, would not press the defendant for payment until the time named in the pencil memorandum, but that if he was in a position to pay before, he would do so. That a letter was sent to the defendant by the authority of the liquidators of the company, a copy of which was, with the consent of the plaintiffs' counsel, put in evidence instead of the original. At the foot of this letter, which was dated the 18th of December 1865, and addressed to the defendant and signed by the liquidators (the company being then in the course of being wound up), were the words "Amount of your promissory note overdue from 4th June 1865." A book of the plaintiffs was also produced, which, the witness said, was the book of local bills discounted, in which he said the entry relating to this note was "term three months" and "rate of discount," but no discount was charged. He further said, that the note was signed some days after the date. That before it was signed a resolution was passed by the directors granting time for its payment. That the pencil note was put the same day it was signed—he should think the same day it was signed—and it was done in accordance with the understanding between the directors and the defendant.

Upon this evidence I was of opinion that this was not a note payable on demand and bearing the date on which it

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was made, and that under Act X. of 1862, Schedule A, Clause 10, a one-anna stamp was not sufficient; and the plaintiffs by their counsel declining to avail themselves of Sec. XVII. of the Act and pay the penalty, the note was not put in evidence. From this it followed that the first issue would be found for the defendant.

The plaintiffs then sought to recover upon the consideration for the note; and the following issues were framed (the plaint being, subsequently during the hearing, amended by inserting, at the request of the plaintiffs' counsel, a claim for the amount of the note and interest, as the price of shares bargained and sold to the defendant, but not accepted by him; and as money found to be due from the defendant to the plaintiffs, on an account stated):—(2) whether the defendant purchased of the plaintiffs the shares in the plaint mentioned on the terms stated; (3) whether the sale of the shares was illegal, or not authorised by the articles of association of the plaintiffs' company; (4) whether the sale was a *bonâ fide* sale and not merely a colourable one; (5) whether the plaintiffs were able to deliver the shares in pursuance of the contract; (6) whether the plaintiffs can now recover the price of the shares, except by suing on the promissory note mentioned in the plaint.

The case then proceeded, and evidence was given for the plaintiffs, that a general meeting of the shareholders of the Eastern Financial Association was held on the 22nd of December 1864, at which a resolution was passed that the capital should be doubled, and the defendant was appointed a director, the then directors having previously appointed him. That advertisements of the sale of 12,500 shares were issued. That the sale was held, and the defendant bid at it; and it was admitted by his counsel that 10,000 shares were knocked down to him, at the price mentioned in the plaint. They were sold in separate lots. That by the conditions of sale, published by the auctioneer, a deposit of Rs. 100 per share was to be paid, and the balance at the end of thirty days from the day of sale. That the defendant did not pay a deposit, but some of the other purchasers did. The

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defendant was appointed by the directors to be a director on the 24th of October, in the place of a director who resigned; and he had been acting along with the other directors for some time previously.

The substantial questions in the case appear to me to be, whether the sale to the defendant was a *bonâ fide* sale, and not colourable only; and whether the plaintiffs were able to deliver the shares in pursuance of the contract, which involves the question, whether the sale was illegal, or was not authorised by the articles of association; in either of which cases the plaintiffs cannot confer upon the defendant a legal title to the shares.

Upon the first of these questions there is the evidence of the defendant, upon which, if it stood alone, I should not place any reliance; he being not only interested in the event of the suit, but having also, by his own account, been an active party in a transaction of a very questionable nature. I must see how far the other evidence, of the truth of which I feel satisfied, makes it probable that his statement is a true one. The plaintiffs' counsel examined him as his witness, but his statements must be looked at in the same way as if his own counsel had called him. His evidence was that, in October 1864, the directors wrote to him a letter, asking him to become a nominal director; that he joined them in October, and took much part in the management of the Financial Association. He was present at the meeting on the 22nd of December, and agreed to the proposition that 12,500 shares should be sold by auction. He believed he bid at an increased rate to the bazár rate, in order to support the shares he then had. It was to increase the bazár rate. He then had about 15,000 shares. He purchased at the auction at a higher rate than it was in the market. He bid for himself alone, but other persons (whose names, and the number of shares each was entitled to, he gave) had an interest in the 15,000. He did not intend to pay for the shares, and did not intend to pay the promissory note. That the other directors held many shares, and were all interested in raising the bazár rate. Before the day of the auction there were

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several conversations that it was desirable to raise the price of the shares, and he undertook to go in and buy at the auction. That his co-directors were aware of his intention to raise the price, and that he could not pay that large amount. That in March 1864 shares were beginning to fall, and they then threatened to put the shares in the market, and lower the price of his old shares. It was agreed by the directors, when he signed the note, that they were not to put him in any difficulty—not to press him.

Now the price at which the shares were sold to the defendant was 42 per cent. premium, and the evidence of Keshavjí Naik, one of the directors of the company, was that, before the meeting of the 22nd of December, the shares were at a premium of from 60 to 65 per cent., and after the meeting and before the auction they were about 80. Allowing for the difference in the value that would be caused by the issue of the 25,000 new shares, this agrees with the defendant's statement, that he purchased at the auction at a higher rate than it was in the market, in order to support the price of the shares and increase the bazár rate. And this was done after conversations with the other directors, who held many shares, that it was desirable to raise the price, and they were aware of the defendant's intention.

But the most material circumstances, indicating the real nature of the transaction and confirming the defendant's evidence, are the entire want of compliance with the conditions of sale, and the subsequent conduct of the parties. By the conditions a deposit of Rs. 100 per share was to be paid at the time of the sale, and the balance within thirty days, and in case of non-payment of the balance the deposit was to be forfeited. No deposit was paid by the defendant. The plaint states that. The plaintiffs' counsel said, in the course of his examination of the defendant, that a cheque was given, but, in some way or other, it was afterwards returned by the Association. If that were so, it would probably be still more significant of the colourable nature of the transaction than the mere non-payment of the deposit. The sale was on the 14th of January, and until March nothing appears to have been

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done upon it. The defendant says that in March the shares were beginning to fall; and the directors then threatened to put the shares in the market and lower the price of his old shares: in consequence of which he gave the promissory note; but that he was not to be pressed, and was to pay only in the event of the shares going up; and the note is given in March with an agreement that it was not to become due till the 4th of June. The parties had probably, when the shares were beginning to fall, become aware that it would be necessary to take some steps to give an appearance of reality to the purchase at the auction. All the circumstances appear to me to lead to the conclusion, that the intention of the parties was what the defendant has stated; and that the sale to the defendant was not a *bonâ fide* one, but was made for the purpose of imposing upon the public and keeping up the price of the shares. The bubble had not then been sufficiently inflated to satisfy the desires of its authors.

Now, upon this state of facts, the plaintiffs cannot recover from the defendant the price of the shares which were knocked down to him at the auction, for two reasons. First, because no shares were really bargained and sold as the plaint alleges; and what was done was, according to the intention and understanding of the parties, a mere form gone through for the purpose of deceiving the public, and making it appear that 10,000 shares had been sold at a certain price. And, secondly, because courts of justice do not enforce contracts made for the purpose of defrauding other persons.

"By constructive frauds are meant such acts or contracts as, although not originating in any actual evil design or contrivance to perpetrate a positive fraud or injury upon other persons, are yet by their tendency to deceive or mislead other persons, or to violate private or public confidence, or to impair or injure the public interests, deemed equally reprehensible with positive frauds, and therefore are prohibited by law as within the same reason and mischief as acts and contracts done *malo animo*. Although, at first view, the doctrines on this subject may seem to be of an artificial, if not of an arbitrary, character; yet upon closer observation they

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will be perceived to be founded in an anxious desire of the law to apply the principle of preventive justice, so as to shut out the inducements to perpetrate a wrong, rather than to rely on mere remedial justice after a wrong has been committed. By disarming the parties of all legal sanction and protection for their acts, they suppress the temptations and encouragements which might otherwise be found too strong for their virtue."—Story's Eq. Jur., Sec. 258. "And here the general rule is, that particular persons in contracts and other acts shall not only transact *bonâ fide* between themselves, but shall not transact *malâ fide* in respect to other persons who stand in such a relation to either as to be affected by the contract or the consequences of it. And as the rest of mankind besides the parties contracting are concerned, the rule is properly said to be governed by the public utility."—"*Ibid.* Sec. 333, quoting from the judgment of Lord *Hardwicke* in *Chesterfield* v. *Janssen* (*g*). Where A agreed to give B a certain sum for goods in advancement of C, a secret agreement between B and C that the latter should pay a further sum was held void as a fraud on A, and B was not allowed to recover upon it"—*Jackson* v. *Duchaire* (*h*). "The reports in every period of the English Jurisprudence and our American reports equally abound with cases of contracts held illegal on account of the illegality of the consideration; and they contain striking illustrations of the general rule, that contracts are illegal when founded on a consideration *contra bonos mores*, or against the principle of sound policy, or founded in fraud, or in contravention of the positive provisions of some statute law"—2 Kent's Comm. 10th ed. 635. "Equally unavailing is the instrument (a bill of exchange or promissory note) if given in fraud of third persons"—Byles on Bills, 8th ed. 121. *Pacta quæ turpem causam continent non sunt observanda.* Dig. lib. 2, tit. 14, l. 27. "Thus it is also an essential character of all covenants that they contain nothing that is unlawful and dishonest, and it is a vice in a covenant if anything is inserted in it contrary to law and good manners."—Domat's Civil Law by Cushing, Part I.,

(*g*) 2 Ves. 156-7; 1 Wh. & Tu., L. C. in Eq. 474.
(*h*) 3 Term Rep. 561.

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Bk. i, tit. 18, par. 1212. "Under the head of fraud it may be observed that any fraudulent practice (to which the word in the original *chhala* is synonymous) vitiates a contract."—Macnaghten's Principles of Hindú Law, 2nd ed. 121. "When the judge discovers a fraudulent pledge or sale, a fraudulent gift and acceptance, or in whatever other case he detects fraud, let him annul the whole transaction."—Manu. Ch. VIII., v. 165. That the rule of the English law is also to be considered as the law in India, appears from the judgment of the Privy Council in *Doolubdass Pettamberdass* v. *Ramloll Thackoorseydass* (*i*).

Upon the ground, therefore, that the sale to the defendant was not a *bonâ fide* or real sale, and that the shares were knocked down to him at the prices he bid for them, in order to deceive and mislead persons who might wish to purchase shares in the company, or to induce persons to purchase at extravagant and improper prices, I am of opinion that the plaintiffs cannot recover. Such a purpose is illegal: *Rex* v. *De Berenger* and others (*j*).

I have hitherto assumed that the resolution, that 12,500 of the new shares should be sold by auction, was authorised by the articles of association, and was not illegal. If it was not authorised or was illegal, the plaintiffs were not able to deliver the shares in pursuance of the contract,—that is to say, they could not confer upon the defendant a legal title to the shares, which was one of the issues raised.

The 9th clause of the articles of association provides "that all additional capital wihch shall be raised for the purposes of the company shall be raised in shares numbered progressively, and either in continuation of the numbers of the shares of the previous capital of the company or otherwise, and shall be divided into shares of such amounts as will allow of the whole amount of such additional capital being apportioned amongst the existing shareholders rateably and in proportion to their respective shares in the existing capital of the company; and that the existing shareholders

(*i*) 5 Moore Ind. App. 131. (*j*) 3 M. & S. 67.

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for the time being shall have the option of taking and subscribing for the shares in such additional capital rateably and in proportion aforesaid." By the existing shareholders having the option of taking and subscribing for the new shares, I think was meant, that the new shares should be offered to the shareholders in proportion to the shares each then held, and a reasonable opportunity offered to them of exercising the right of taking them.

Whether it was necessary to make the offer by a notice to each shareholder specifying the number of shares to which he was entitled, as is required by Cl. 27 of the Regulations given in the first schedule to the Indian Companies' Act, or it would have been sufficient to have published a general notice calling upon the shareholders within a specified time to state whether they wished to take the shares, it is not necessary to determine, as this was not done. The notice of the meeting, at which the resolution to increase the capital was passed, cannot be considered as equivalent to such a notice; and, although the shareholders who were present at the meeting and voted for the resolution may be considered to have thereby exercised their option, those who did not vote, and still more those who were not present cannot be held to have done so. The 9th clause is imperative and not merely directory, and so long as it was one of the articles of association, a deviation from it could not be made, unless with the assent of every shareholder: *Ex parte Bignold* (*k*).

It was contended by the plaintiffs' counsel that the shareholders had renounced their option, and several cases were cited; but they appear to me to be distinguishable from this case; and in all of them either something had been done, or some benefit had been derived, which amounted to a ratification by, or an equitable estoppel upon, the parties affected by the acts of the directors. Or, as in *Bargate* v. *Shortridge*, there had been a course of dealing by which the parties, who sought to set up the want of observance of the formalities

(*k*) 22 Beav. 143; 25 Law J., Ch. 601.

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required by the deed, were bound. But it may be said that the defendant was himself estopped from objecting that the 9th clause had not been observed, as he attended the meeting and voted for the resolution. And if upon the facts it had appeared that this was a real sale, and that the defendant was aware of the 9th clause, and knowing that the shareholders had not had an opportunity of exercising their option, had purchased the shares, there would be ground for holding that he purchased them with such a title as could under the circumstances be given, and was bound to take them, subject to the risk of any shareholder claiming to exercise his option; but the case must be decided upon all the facts in evidence, and if the plaintiffs seek to treat the transaction as a real sale he may defend himself on the ground that the 9th clause was not complied with.

I do not think it necessary to give any opinion upon the objections which were raised under the 7th and 8th clauses of the articles. If my opinion had been in favour of the plaintiffs on the main questions, I should have been reluctant to give effect to those objections, and I am inclined to think that none of them is sustainable; but I do not decide upon them, and if this case should go before the Court of Appeal it will be competent for the defendant's counsel to rely upon them in support of this judgment.

For the reasons I have above given, I think the defendant is entitled to the judgment of the court, but it is not a case in which he ought to be allowed his costs.

Judgment for defendant without costs.

Attorneys for plaintiffs: *Dallas, Lynch & Langdale.*

Attorneys for defendant: *Kelly & Co.*