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[152] APPELLATE CIVIL.

Before Sir Charles Sargent, Kt., Chief Justice, and Mr. Justice Bayley.

BHIMBHAI AND OTHERS (*Appellants*) *v.* ISHWARDAS JUGJIWANDAS AND ANOTHER (*Respondents.*)* [20th February, 1893.]

Company—Indian Companies Act (VI of 1882), s. 13—Contributory—Increase of capital—Illegal issue of shares—Reduction of capital.

The Nawab of Beyla Spinning, Weaving Manufacturing Company, Limited, was registered under the Indian Companies Act (X of 1866). The original capital of the company consisted of Rs. 4,00,000, divided into 1,600 shares of Rs. 250 each. In 1882 the capital of the company was increased by Rs. 1,00,000 divided into 1,600 shares of Rs. 62-8. The resolution to increase the capital was not passed in accordance with the articles of association, *i.e.*, "with the sanction of a special resolution of the company passed at a general meeting." On the 5th November, 1884, a resolution was passed at a general meeting of the company that the shareholders should take up the 459 shares of the original capital and 1,027 shares of the increased capital, which were then in the hands of the company, in the proportion of one share to every two shares already held by them. In pursuance of this resolution the appellants took up several shares of the original capital as well as of the new capital. On 19th October, 1885, a general meeting of the company was held at which it was resolved that the resolution of the 5th November, 1884, and all acts done in connection with it should be set aside, that the shares taken by the shareholders in pursuance of that resolution should be taken back by the company, and such amounts as had been paid by them on those shares should be credited to their names in the company's books. This was accordingly done, and the shares were transferred to the name of the company. In October, 1886, the company was wound up by order of the Court. In settling the list of contributories, the District Judge of Surat held that the appellants were liable, as contributories, in respect of all the shares which they had taken up in pursuance of the resolution of 5th November, 1884. On appeal from this decision,

Held, that with respect to the shares of the original capital, the resolution of the 19th October, 1885, was illegal and invalid. It operated, not as an investment by the company of its funds in its own shares, but as an extinguishment of the shares, and such extinguishment was virtually a reduction of the capital, which could not be done without complying with the provisions of s. 13 of the Indian Companies' Act (VI of 1882). The holders of such shares were, therefore, properly placed on the list of contributories.

Held, also, that the issue of the shares of the new capital was illegal, as the resolution to increase the capital had not been come to in accordance with the articles of association. It was, therefore, open to the company to set aside the resolution of 5th November, 1884. When it was set aside, the persons who held the new shares ceased to be shareholders, and could not, therefore, be held liable as contributories.

[F., 20 B. 654; R., 14 Bom. L.R. 521=16 Ind. Cas. 49.]

[153] APPEALS from the orders of J. B. Alcock, District Judge of Surat, in the matter of settling the list of contributories of the Nawab of Beyla Spinning, Weaving and Manufacturing Company, Limited, in liquidation.

The company was formed and registered in 1881 under the Indian Companies Act X of 1866.

The original capital of the company consisted of four lakhs of rupees, divided into 1,600 shares of Rs. 250 each.

In November, 1882, the capital of the company was increased by a lakh of rupees by the issue of 1,600 shares of Rs. 62-8-0 each.

* Appeals Nos. 121, 146, 147 and 166 of 1892.

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The resolution to increase the capital was not passed, in accordance with the articles of association, under which "the sanction of a special resolution of the company passed in a general meeting" was required before the capital could be increased. No such sanction was obtained for the issue of the new shares.

On 5th November, 1884, a general meeting of the company was held, at which a resolution was passed calling on each shareholder to take up one additional share either of the original or of the new capital for every two shares originally held by him. The material portion of the resolution was to the following effect:—

"At present there are in the Company's hands 459 shares of the original capital of Rs. 250 each, and 1,027 shares of the increased capital of Rs. 62-8-0 each. The present shareholders must take up the unallotted shares in the proportion (of one share for every two shares already held). The shareholders must pay the whole of the amount due on the said shares within eight days from this date and take the shares."

In pursuance of this resolution the appellants, in common with the other shareholders, took up a certain number of shares of the original as well as of the new capital.

On 19th October, 1885, it was resolved at a general meeting of the shareholders to set aside the resolution of the 5th November, 1884, and all acts done under that resolution. This resolution was to the following effect:—

[154] "It is hereby resolved that the resolution (of the 5th November, 1884) and the notices issued thereunder and all orders passed and acts done in connection therewith be set aside. And in order to return such amounts as have been paid by the shareholders under the said resolution, the same are to be credited to the names of such shareholders with interest at 12 annas per cent. per mensem from the date on which the same may have been paid by them; and when the company gets money, it is to pay to such shareholders all such moneys with interest as may stand credited in their names. And the company is to take back from the shareholders the share certificates issued to them under the said resolution hereby set aside. And the moneys received under the said resolution having been credited to the names of the shareholders, who may have paid them, are to be deducted from the capital account, and the shares taken back are to be shown as a balance in the capital account."

Accordingly on the 19th June, 1886, the shares, which the appellants had taken up in pursuance of the resolution of the 5th November, 1884, were taken back and transferred from their names to the company, and the moneys which they had paid on those shares were credited to their account in the company's books.

On 30th October, 1886, the company was wound up by and under the order of the Court.

In settling the list of contributories of the company, the District Judge of Surat was of opinion that the resolution of the 19th October, 1885, was illegal and *ultra vires*, as it had the effect of reducing the capital of the company without the formalities required by s. 13 of the Indian Companies Act (VI of 1882), and also because the company had no power to purchase its own shares, in contravention of s. 282 of the Act. He, therefore, held that the appellants were shareholders of the company at the date of its winding up, and as such liable to be placed on the list of contributories, in respect of all the shares they had taken up in pursuance of the resolution of the 5th November, 1884.

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Against this decision the present appeals were preferred to the High Court.

[155] *Kalabhâi Lalubhai* (with *Manekshah Jahangirshah* and *Manchubhai Narsidas Choksi*), for appellants:—The appellants are not liable in respect of the shares taken by them under the resolution of the 5th November. As to the new shares the resolution by which the capital of the company was increased was illegal and *ultra vires*. It was not a 'special resolution' as required by the articles of association. Nor was the resolution of the 5th November, 1884, compelling the shareholders to take up additional shares against their will, legal and binding on the shareholders. The company saw its mistake in time, and cancelled this resolution. The lower Court has held that this could not be done, as it had the effect of reducing the capital. This view of the matter is clearly wrong. It was perfectly competent to the company to undo an illegal act, and cancel the new shares which had been illegally issued. We never acquiesced in the illegality; we are, therefore, not estopped from pleading it as a complete defence to the present proceedings. *Campbell's case* (1) has no application to the present case. If any person is estopped, it is the official liquidators as representing the company. It is not open to them to say that the resolution of the 19th October, 1885, passed by the whole body of shareholders was null and void. That resolution does not effect, and was not intended to effect, a reduction of the capital of the company. It only transfers the shares back to the company, and amounts to an "investment by the company of its funds in its own shares" as provided by cl. (*j*) of s. 3 of the memorandum of association. The official liquidators cannot, therefore, impeach the exercise of this power as illegal or invalid—*In re Mercantile Credit and Financial Association* (2); *Jehangir Rustomji Modi* v. *Shamji Ladha* (3); *Sewell's case* (4); *Feiling's and Rimington's case* (5).

Gonpat Sadashiv Rao, for respondents (official liquidators).—The shares in respect of which the appellants are placed on the list of contributories are partly shares of the original capital and partly of the new capital. As regards the shares of the original [156] capital, the resolution of the 19th October, 1885, was absolutely null and void. The company had no power to take back these shares, and credit the shareholders with the moneys they had paid on those shares. That had clearly the effect of reducing the original capital, and this could not be done except in accordance with s. 13 of Act VI of 1882. It is admitted that the formalities prescribed by that section have not been complied with. The resolution, therefore, so far as it effects a reduction of the original capital, is illegal. It is, however, urged that the effect of the resolution is to invest the funds of the company in its own shares, and that cl. (*j*) of s. 3 of the memorandum of association empowers the company to make such an investment. The proper construction to put upon this clause in the memorandum of association would be that such investment can only be made if there is actual cash in the hands of the company. But at the date of the resolution in question the company had no funds in its hands. It was deeply indebted. If there were no funds to invest, how could there be any investment at all? The object of the resolution was not to make the investment as suggested, but to cancel the shares and reduce the capital *pro tanto*. Such a reduction was illegal. Even if the

(1) L. R. 9 Ch. 1. (2) 3 B.H.C.R. O.C.J. 125. (3) 4 B.H.C.R. O.C.J. 185.
(4) L. R. 3 Ch. 131. (5) L. R. 2 Ch. 714.

transaction be treated as a purchase by the company of its own shares, it is still invalid. See s. 249 of Act VI of 1882, and *Trevor* v. *Whitworth* (1). Under either aspect of the case, the resolution of the 19th October, 1885, should be treated as null and void.

As regards the shares of the new capital, there was, no doubt, an irregularity in the issue of these shares. But that will not relieve the shareholders from liability as contributories. They took the shares with full knowledge of the irregularity. They have acquiesced in it. They are, therefore, estopped from impugning the validity of the issue of the shares—*In re Miller's Dale and Ashwood Dale Lime Company* (2); *Challis case* (3); *Hare's case* (4); *Stace and Worth's case* (5); *Campbell's case* (6); *Sewell's case* (7).

JUDGMENT.

[157] SARGENT, C. J.—The question in these appeals from the orders of the District Judge directing the appellants to be retained on the list of contributories turns upon the legal effect of the proceedings of the company commencing in 1882 and down to 10th October, 1886, when the order for winding up the company began to operate. It appears that in 1882, the company being anxious to extend its business, the directors passed a resolution that each of the shareholders should take up a new share of Rs. 62-8-0. Some shares were accordingly taken up under this resolution; but the requisite capital not being forthcoming, a general meeting of the company was held on the 5th November, 1884, on which occasion it was resolved that the shareholders should take up the 459 shares of the original capital at Rs. 250 per share and 1,027 shares of increased capital at Rs. 62-8-0 then in the hands of the company in proportion to the shares held by them, and in pursuance of that resolution a great many shares of the original and new capital were taken up, both of which form the subject of one or other of the present appeals.

The shares in respect of which it is sought to place the appellants on the lists of contributories were taken up in pursuance of that resolution. However, on the 19th October, 1885, at a general meeting it was resolved "that the resolution of 5th November, 1884, and the notices issued thereunder and the orders passed and all the acts done in connection therewith be set aside, and in order to return such amounts as had been paid by the shareholders under the said resolution it was resolved that the same should be credited to the names of such shareholders with interest whatsoever it might amount to at 12 annas per cent. per mensem from the date on which the same might have been paid by them, and when the company should get money it should pay such shareholders all such moneys and interest as might stand credited in their names, the company to obtain receipts from them and to take back from the shareholders the share certificates granted to them under the said resolution so set aside, the moneys received having been credited to the names of the shareholders who may have paid them to be deducted from the capital account and the shares taken up to be shown as a balance in the capital account." The important question in the case is as to [158] the effect of this resolution on the shares taken up by the resolution of 5th November, 1884.

(1) 12 Ap. C. 409 (437). (2) 31 Ch. D. 211. (3) L. R. 6 Ch. 266.
(4) L. R. 4 Ch. 503. (5) L.R. 4 Ch. 682. (6) L.R. 9 Ch. 1.
(7) L.R. 3 Ch. 131.

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First, we will consider its effect on the shares which formed part of the original capital. They could of course be issued whenever the company might think proper, but when issued they became part of the capital of the company, which could only be subsequently reduced by complying with the provisions of s. 13 of the Companies Act of 1882, which was admittedly not done in this case. But it was said that what was intended to be done by the resolution of October, 1885, was the extinguishment or cancellation of shares, and was not in form a reduction. It is plain, however, that it would virtually be a reduction, as pointed out by Lord Justice James in *Hope* v. *International Financial Society* (1). Referring to the transaction of that society he says: "It was either a purchase of shares in the sense of trafficking in shares, which is a purchase not authorized by the memorandum of association," or "it is an extinguishment of shares and, therefore, a reduction of capital." These remarks are referred to with approval by Lord Herschell in the important case of *Trevor* v. *Whitworth* (2). Again, it has been contended for the appellants that the resolution operated as an investment by the company of its funds in its own shares, and which, it was said, was authorized by sub-cl. (*j*) of s. 3 of the memorandum of association, which provides that among the objects for which the company was established "was to invest the funds of the company from time to time in the shares of the company, provided that the company shall at no time hold more than one-fourth of the total number of shares for the time being of the company." In answer to this it has been argued for the official liquidators that such a power of investment by the company being virtually a power to purchase its own shares was *ultra vires* although found in the memorandum of association. There is no express decision of the English Courts, although a strong opinion was expressed by Lord Macnaghten to that effect in *Trevor* v. *Whitworth* (2). It is true that by s. 249 of the Act of 1882 a purchase by a company of its own shares is strictly forbidden, which Act was in force when the transaction in [159] question took place; but every "right acquired" under the Act of 1866, which would, we think, include a right of the company to invest in its own shares under its memorandum of association registered under that Act, was saved by cl. (*b*) of s. 2 of the Act of 1882. However, it is not necessary, in the view we take of the transaction, to express a decided opinion as to whether such a power of investment could have been validly exercised in 1885, as we are clearly of opinion that the transaction in question cannot be sustained as an investment, but that it was really an extinguishment of the shares. The resolution is distinct in its terms as undoing what had been done in November, 1884, with a *restitutio in integrum*—the money was to be returned with interest to the shareholders, and the share certificates taken back by the company, and the shares "shown as a balance in the capital account." There was no intention of re-issuing these shares, and the result of the resolution, if carried out, would, therefore, have been, not an investment of the funds of the company in its shares, but the extinguishment of the capital represented by those shares. This is clearly pointed out by the present Master of the Rolls in *Hope* v. *International Financial Society* (1), and by Lord Herschell in *Trevor* v. *Whitworth* (2). It is impossible, therefore, in our opinion to say that the resolution operated as an investment of the company's

(1) 4 Ch. D. (327) 340. (2) 12 Ap. Ca. 419.

funds in its shares, and we must, therefore, decide that the holders of such shares were properly placed on the list of contributories to the extent of so much of the Rs. 250 on each share as had not been already paid to the company at the time of the winding up.

As to the shares of the issue of new capital, they stand on a different footing. That issue was admittedly invalid, the resolution to increase the capital not having been come to in accordance with ss. 4 and 5 of the articles of association,—that is, "with the sanction of a special resolution of the company passed in general meeting." The shares, therefore, not having been validly issued by the company, and the invalidity not having been subsequently cured, as was done in *Sewell's case* (1), they never became a legal part of the capital of the company; and it [160] was, therefore, in the power of the company by a resolution of a general meeting to set aside the resolution of November, 1884, so far as that issue of shares was concerned, and validly undo what had been done under that resolution. This was effected by the resolution of 19th October, 1885, which set aside all that had been done under the resolution of 5th November, 1884, and virtually cancelled the shares issued under it. The persons who had taken up these shares ceased then to be holders of the shares and became creditors of the company in respect of the moneys they had paid on the shares and for which they were credited in the company's books in June, 1886; they cannot, therefore, be regarded as having been shareholders in respect of those shares when the winding up commenced. This case differs, therefore, from *In re Miller's Dale and Ashwood Dale Lime Company* (2), where there had also been an invalid increase of capital, but which had never been undone, and the shareholders who sought not to be placed on the list of contributories had kept the shares which had been invalidly issued for several years and were on the list of shareholders when the winding up commenced.

We must, therefore, reverse the orders appealed from of the Court below and send back the cases for fresh decisions having regard to the above remarks. Costs to abide the result.

Orders reversed.

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APPELLATE CIVIL.

Before Mr. Justice Bayley (Acting Chief Justice), Mr. Justice Jardine and Mr. Justice Telang.

CHUNILAL VITHALDAS (*Original Defendant No.* 2), *Appellant v.* FULCHAND (*Original Plaintiff*), *Respondent.** [20th February, 1893.]

Mortgage—Marshalling of securities—Notice of prior mortgage to subsequent mortgagee—Doctrine of marshalling applicable to mortgages in the Mofussil.

Before the extension of the Transfer of Property Act, 1882, to the Bombay Presidency, where two properties had been mortgaged to one person, and one of them was subsequently mortgaged to another person with notice of the former mortgage.

Held, such subsequent mortgagee had an equity to call for a marshalling of the securities in his favour so as to require the first mortgagee to proceed to realize

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* Second Appeal No. 224 of 1891.

(1) L.R. 3 Ch. 139. (2) 31 Ch. Div. 215.