

* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

Judgment Reserved on: March 31, 2014

Judgment Delivered on: April 03, 2014

+ **RFA(OS) 71/2013**

PEEYUSH AGARWAL

..... Appellant

Represented by: Mr.Sachin Chopra, Advocate
with Mr.Anuj Tyagi,
Ms.Maitry Kakade and
Ms.Noor Nisha, Advocates

versus

SANJIV BHAVNANI & ORS

..... Respondents

Represented by: Mr.Meet Malhotra,
Sr.Advocate instructed by
Mr.N.P.S.Chawla, Mr.Gaurav
Varma, Mr.Karamveer Jindal,
Advocates for R-1
Mr.Ravi Gupta, Sr.Advocate
instructed by Mr.Kamal Bansal,
Advocate for R-2 & 3

CORAM:

HON'BLE MR. JUSTICE PRADEEP NANDRAJOG

HON'BLE MR. JUSTICE JAYANT NATH

PRADEEP NANDRAJOG, J.

1. Impleading the first respondent as the sole defendant, the appellant filed a suit praying a declaration to be granted in its favour that 1397150 (Thirteen Lacs Ninety Seven Thousand One Hundred Fifty) shares of the company Vishesh Infotechnics Limited presently in the name and custody of the respondent No.1 be declared to be the shares of the appellant. Permanent injunction was prayed to restrain respondent No.1 from dealing

with the said shares. Mandatory injunction was prayed that the first respondent be directed to transfer the shares in the name of the appellant and hand over possession of the share certificates.

2. The action was maintained on the plea that the first respondent was an employee of the company Vishesh Infotechnics Ltd. and had a small shareholding therein of around 11000 (Eleven Thousand) shares. The appellant acquired majority shareholding of the company by purchasing the shares from the erstwhile management and at that time the first respondent was a joint Managing Director of the company. That the appellant was also a majority shareholder in another company named MPS Technosoft Ltd. That the first respondent told the appellant that he was facing difficulties in convincing investors and clients that he had a vital interest in the two companies Vishesh Infotechnics Ltd. and MPS Technosoft Ltd. He told the appellant that investors would be assured in the dealings with the companies if he had a substantial holding in MPS Technosoft Ltd. and thus it was agreed that appellant would park shares of MPS Technosoft Ltd. with the first respondent and therefore on April 27, 2004; 3197150 (Thirty One Lacs Ninety Seven Thousand One Hundred Fifty) Shares of MPS Technosoft Ltd. were transferred in the name of the first respondent, to be kept in trust by him. To give effect to the aforesaid understanding 997150 (Nine Lacs Ninety Seven Thousand One Fifty) shares of a holding company controlled by the appellant named Omkam Developers Pvt.Ltd. and 2200000 (Twenty Two Lacs) shares held by another holding company of the appellant named BGR Finvests Private Ltd. were transferred in the name of the first respondent. It was pleaded that since it was actually a case of shares to be held in trust no stamp duty or transfer fee was paid when the shares transfer

took place. Pleading further that as per a scheme of merger, since MPS Technosoft Ltd. merged with Vishesh Infotechnics Ltd., the first respondent was issued 2397863 (Twenty Three Lacs Ninety Seven Thousand Eight Hundred Sixty Three) shares of Vishesh Infotechnics Ltd. It was pleaded that the respondent held these shares in trust. Pleading that as per the asking of the appellant the first respondent transferred substantial shares standing in his name to different parties, it was stated that currently 1397150 (Thirteen Lacs Ninety Seven Thousand One Hundred Fifty) shares were in the name of the first respondent in the company Vishesh Infotechnics Ltd.

3. In the written statement filed the respondent pleaded the bar of limitation as a technical defence apart from another technical defence that neither Omkam Developers Pvt.Ltd. nor BGR Finvests Pvt.Ltd. being impleaded as defendants the suit was liable to be dismissed. And on merits, claimed to be the lawful and rightful owner of the shares. He pleaded that 3197150 (Thirty One Lacs Ninety Seven One Hundred Fifty) shares of MPS Technosoft Ltd. were transferred to him by Omkam Developers Pvt.Ltd. and BGR Finvests Pvt.Ltd. in consideration of he transferring 819652 (Eight Lacs Nineteen Thousand Six Hundred Fifty Two) equity shares of a company Infotechnics India Ltd. to the appellant.

4. The first respondent filed IA No.8673/2010 under Order VII Rule 11 of the Code of Civil Procedure pleading that the plaint was liable to be rejected for two reasons. Firstly, Omkam Developers Pvt.Ltd. and BGR Finvests Pvt.Ltd. not being impleaded as defendants required the plaint to be rejected for non-joinder of necessary parties. The first respondent pleaded that it was settled law that a company is distinct from its shareholders. He pleaded that the appellant had itself pleaded in the plaint that the said two

companies had transferred 3197150 (Thirty One Lacs Ninety Seven Thousand One Hundred Fifty) shares held by them of the company MPS Technosoft Ltd. The second plea was that the suit was barred by limitation.

5. We need to highlight at this stage that the case of the appellant in the plaint was that the shares in respect whereof the suit was filed were lying in trust with the respondent No.1 and that he was not the owners of the shares. The defence of the first respondent was one of swapping of shares. It was not the case of the first respondent that it was a benami transaction. The first respondent did not plead any defence with reference to Section 153 of the Companies Act, 1956. The rejection of the plaint was sought on two legal pleas pertaining to non-joinder of necessary parties and the bar of limitation.

6. The order sheet would reveal that the application for rejection of the plaint was first heard by the learned Single Judge on February 19, 2013. The learned Single Judge recorded that as per his reading of the plaint, prima facie, it appeared that the claim in the suit was hit by The Benami Transactions (Prohibition) Act, 1988. The order dated February 19, 2013 records that since this was not the ground urged by the respondent No.1 for plaint to be rejected, the matter was adjourned to the next day i.e. February 20, 2013. On which date as recorded in the order sheet, arguments were concluded.

7. The decision was pronounced on July 04, 2013.

8. Noting that after IA No.8673/2010 was filed the appellant had impleaded Omkam Developers Pvt.Ltd. and BGR Finvests Pvt.Ltd. as defendants No.2 and 3, the learned Single Judge has held that the plea for rejection of the plaint due to non-joinder of necessary parties was no longer

available. On the bar of limitation the learned Single Judge has held that the suit would not be barred by limitation.

9. But the plaint has been rejected holding that the claim was barred under the Benami Transactions (Prohibition) Act, 1988. The learned Single Judge has also held that the suit would not be maintainable because Section 153 of the Companies Act, 1956 prohibits entering of any notice of trust, express, implied or constructive on the Register of Members of the Company. In other words the learned Single Judge has held that a plea had been raised in the plaint concerning the shares which was prohibited by law.

10. Evidenced from paragraphs 15 and 16 of the impugned order it is apparent that neither party had argued on the maintainability of Suit with reference to Section 153 of the Companies Act, 1956. The learned Single Judge has obviously chanced upon Section 153 of the Companies Act, 1956 when he was bestowing his pensive thought to the plaint.

11. In our opinion if after arguments are reserved and while penning an opinion a Judge forms a prima facie view with respect to the maintainability of the suit premised on a legal position which was never argued before the learned Judge, it would be imperative to list the matter for directions so that the parties could have a chance to present their views to be judged. It has to be so in an adversarial adjudication system which we follow in India. Decisions are after all the opinion of the Judge on the basis of what was argued and certainly not a bobby trap.

12. As we find from the order sheet, and as we find from the written statement filed by the first respondent as also from IA No.8673/2010 filed by him under Order VII Rule 11 of the Code, no plea pertaining to the Benami Transactions (Prohibition) Act, 1988 was urged but since the

learned Single Judge was of the view that prima facie the case pleaded was hit by the said Act, he recorded so in the order dated February 19, 2013 and adjourned the matter to the next day to enable the appellant to respond. The same was required even with respect to the view formed by the learned Single Judge with reference to Section 153 of the Companies Act, 1956.

13. Notwithstanding that we could have set aside the impugned order on account of the facts noted hereinabove with respect to the view taken by the learned Single Judge that in view of Section 153 of the Companies Act, 1956 the plea that the shares were held in trust by the respondent No.1 was not maintainable, for the reason parties were not heard on said aspect of the law; with consent of learned counsel for the parties we heard arguments on said aspect of the matter as well.

14. On two counts the plaint has been rejected. The first is that the pleadings in the plaint would attract the The Benami Transactions (Prohibition) Act, 1988. The second of Section 153 of the Companies Act, 1956 prohibiting a plea that the shares were held in trust.

15. As recorded by us in our order March 31, 2014, when we heard arguments and reserved the matter for judgment, learned Counsel for respondent No.1 had fairly conceded that the bar/prohibition imposed by the The Benami Transactions (Prohibition) Act, 1988 would not be applicable in the instant case i.e. that he could not sustain the impugned judgment on the view taken by the learned Single Judge.

16. Indeed, the view taken by the learned Single Judge is contrary to law because the The Benami Transactions (Prohibition) Act, 1988 defines a '*Benami transaction*' to mean any transaction in which property is transferred to one person for a consideration paid or provided by another

person. In the plaint it was never pleaded that while transferring the shares in the name of the first respondent consideration was paid by the appellant or any other person on his behalf. As per the plaint the shares were parked with the first respondent.

17. Section 153 of the Companies Act reads as under:-

“Trusts not to be entered on register:

No notice of any trust, express, implied or constructive, shall be entered on the register of members or of debenture-holders”

18. What this section provides for is that a company shall not record in its register of members or debenture-holders anything to show that as between the members or debenture-holders whose name is entered in the register and any other person, there is any kind of relationship as trustee or beneficiary. The register is not to show and the company is not to take any notice of such relationship.

19. The reason behind this section is twofold: firstly, to relieve the company from any obligation to take notice of equitable interests in its shares, that is to say, to take notice of third party rights in respect of the shares registered in the names of any members and secondly, to preclude any person claiming an equitable interest in the shares from treating the company as trustee in respect thereof. The effect is that a beneficiary who is not entered as a holder of shares has no connection with the company and does not enjoy any rights in the company in which any shares are held in trust for him. This does not, however, prevent a company from recognizing a trust of which it actually has taken notice of, though it must not enter it on the register. The provision will equally apply to debentures.

20. The purpose behind Section 153 was lucidly explained in Re Perkins (1890) 24 QBD 613 as:-

“It seems to me extremely important not to throw any doubt on the principle that companies have nothing whatever to do with the relations between trustees and their cestuique trust in respect of shares of the company. If a trustee is on the company’s register as a holder of shares, the relations which he may have with some other person in respect of the shares are matters with which the company has nothing whatever to do; they can look only to the man whose name is on the register.”

21. In the same case it was said *“the law has given the company the right to say we do not care whether you are cestuique trust or not; if you are; we have a right to take no notice of you.”*

22. The wording of the section evinces that no notice of any trust shall be entered into the register of the members or debenture holders so that the register being notice to persons dealing with the company as regards the ownership of any shares or debentures may not be affected by the entry of any kind of trust. The company itself may not properly refuse to take notice of or recognize any trust brought to its notice otherwise than by entry in the register or to act in accordance with the terms of such notice. If a company has notice about a trust or equitable interest in the shares held by a member, other than by way of an entry in its register of members, the directors cannot register a transfer of such shares and if they do so they shall incur a personal liability to any affected third party. [(1884) 14 QBD 424, Societe Generale de Paris v. Tramways Union].

23. The bar exists only with respect to notice of trust by an entry into the register. There is no prohibition on the company taking notice through any

other evidence. [(2007) 78 CLA 374 (Ker) Damien Subsidies and Kuries Ltd. v. Jose Pulicken; AIR 1971 Mad 293 Parmeswari S. v. Kamdhenu Metal Rolling Mills]

24. Thus, a court can take notice of any trust affecting any shares in a matter before it and serve upon a company a ‘stop notice’ preventing it from dealing with certain shares. [(1884) 14 QBD 424, Societe Generale de Paris v. Tramways Union].

25. Section 153 had become diluted after the introduction of Section 187C which provided that companies are bound to take notice of trust holdings [(1995) 82 Com Cases 539 (CLB-Bom) Bharat Petroleum Corporation Ltd. v. Stock Holding Corporation of India Ltd. affirmed by Bombay High Court in the decision reported as (1997) 3 Comp LJ 112 (Bom) Stock Holding Corporation of India Ltd. v. Bharat Petroleum Corporation Ltd.] However Section 187C stands omitted now.

26. There might be cases where the company might be aware that a particular member is merely a trustee of the shares entered against his name. In such a situation, the company can recover from him the calls and enforce other obligations of membership against him to the full extent and not merely to the amount of trust estate. [AIR 1943 Cal 440 Murshidabad Loan Office Ltd. v. Satish Chandra Chakravarti] However, the member is entitled to be indemnified from the real owner with respect to the said amount. [(1901) AC 118 (PC) Hardoon v. Belilios]

27. Section 153B of the Companies Act, 1956 states that:

“Declaration as to shares and debentures held in trust:

(1) Notwithstanding anything contained in section 153, where any shares in, or debentures of, a company are held

in trust by any person (hereinafter referred to as the trustee), the trustee shall, within such time and in such form as may be prescribed, make a declaration to the public trustee.

(2) A copy of the declaration made under sub-section (1) shall be sent by the trustee to the company concerned, within twenty-one days, after the declaration has been sent to the public trustee.

(3) (a) If a trustee fails to make a declaration as required by this section, he shall be punishable with fine which may extend to five thousand rupees and in the case of a continuing failure, with a further fine which may extend to one hundred rupees for every day during which the failure continues.

(b) If a trustee makes in a declaration aforesaid any statement which is false and which he knows or believes to be false or does not believe to be true, he shall be punishable with imprisonment for a term which may extend to two years and also with fine.

(4) The provisions of this section and section 187B shall not apply in relation to a trust

*(a) where the trust is not created by instrument in writing ;
or*

(b) even if the trust is created by instrument in writing, where the value of the shares in, or debentures of, a company, held in trust

(i) does not exceed one lakh of rupees, or

(ii) exceeds one lakh of rupees but does not exceed either five lakhs of rupees or twenty-five per cent of the paid-up share capital of the company, whichever is less, or

(c) where the trust is created, to set up a Mutual Fund or Venture Capital Fund or such other fund as may be approved by the Securities and Exchange Board of India established under sub-section (1) of section 3 of the Securities and Exchange Board of India Act, 1992 (15 of 1992).

Explanation: The expression " the value of the shares in, or debentures of, a company " in clause (b) means,

(i) in the case of shares or debentures acquired by way of allotment or transfer for consideration, the cost of acquisition thereof, and

(ii) in any other case, the paid-up value of the shares or debentures.

(5) The provisions of this section shall not apply on and after the commencement of the Companies (Amendment) Act, 2000."

28. Sections 153A and 153B were inserted by the Companies (Amendment) Act, 1963. The Statement of Object and Reasons appended to the Bill has been reproduced as under:

"In order to prevent the use of the voting rights attached to shares held by trusts for the advancement of personal interests of the donors, it is considered necessary to regulate the exercise of such rights in suitable cases. For this purpose, it is proposed to empower the Central Government to appoint a person to exercise voting rights in respect of trusts with respect to significant shareholding, when necessary, with a view to securing proper management of the company in the interests of the shareholders."

29. The Finance Minister's statement at various stages of the Bill are pertinent to understand the object and scope of the said amendment Act:-

"While Government have no intention to interfere with

the position of trust's equities, it has often happened that certain types of trusts hold large amounts of equities and the people who are in management of these trusts use those equities for the purpose of having control. Various provisions that we have in regard to limiting the amount of control by excessive accretion of equity capital in the hands of any single group of persons are all defeated by the fact that these shares are held by trusts undoubtedly intended for good purposes but incidentally being used for the purpose of keeping their control over the company. I have no intention to labour this point, because it is clear. In fact, my Hon. friend Shri Tyagi, as Chairman of Direct Taxes Administration Enquiry Committee has drawn attention to this fact of trust funds being invested and utilized for furthering donor's business interests. The provision now is that in the case of such trusts where the clear intention is known – it is not overall charitable or educational trusts, Government, if it so desires, may appoint a person to exercise the voting rights in order to safeguard trust's right attached to such shares and the trustees shall not exercise their voting rights. The amendment exempts genuine trusts created for safeguarding family interests or charitable or educational trusts and where the amounts invested in the shares of any single company by trust exceeded one lakh of rupees, the operation of the law comes in.

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An officer appointed by the Central Government would be entitled to receive all books, all notices of the meetings, copies of the resolutions and accounts and other documents as if he was a member of the company and he will use his proxy for the benefit of the company's general interest rather for the benefit of an particular individual concern”.

(Lok Sabha Debates, dated 28th November, 1963 XXII, pages 2003-2004).

30. When witnesses were being examined by the Select Committee with reference to the provisions of the Bill, the Finance Minister explained the underlying object of these provisions to the witnesses as under –

“ The intention is only this; that the holding of securities by trusts should not be used by a group of persons for the purpose of augmenting their own voting rights. That is the main intention. It is not a question of divesting anybody of any rights. I do not see how the identification of the rights of the person who exercises the right to vote and that of the trust can be equated. Here nothing is sought to be taken away, except that you do not exercise the vote direct but exercise it through a public trustee...

It is known that that a very large amount of holding of equities is in possession of trusts, be they private or public or charitable trusts. All these trusts are controlled by a person or by a group of persons. Those persons who control the trusts, again are people who control companies or seek to control them through their securities. What is sought here is that the merging of the two elements of control does not become a big one. Therefore, we say that the right exercised by a person who is a trustee exercising the rights of the trust as shareholder, though not recognised by company law, shall be transferred on to a public trustee....the overall intention of the government is that the aggregate of the voting rights of an individual who controls the trust and the property of the trust as such which is handles, is not used for some purpose not wholly necessary in the interests of the trust...We do not want to interfere with the ordinary right of a person who is managing a trust as a shareholder. But there should not be an aggregation of these voting rights merely because of the two personalities coalescing at some stage”

(Explanation given by the Finance Minister during the examination of witnesses by the Select Committee 6th December, 1963 Evidence Vol. I, page 12-13).

31. Again during the debates on the Bill after the report of the Select Committee, the Finance Minister further explained the underlying purpose of these provisions as follows:

“The public trustee will step into the position where the holding of a trust in one company’s share is a little above one lakh in some cases and five lakhs in all others, and having stepped into that position, he can, in the case of good trustees, authorize the trustees themselves to act on his behalf. Often times, shareholders do not exercise their rights. Dumb creatures in this world are often shareholders; they never exercise their rights. The public trustee could permit a trustee to do it. Provision has been made for that. But when he finds that it is not wise to do so- he will have the information at his disposal- he will exercise it, if necessary, for the purpose of preserving the interest of the trust. The real thing is that normally we say that the public trustee shall not vote except where he has to defend the rights of the trust.”

(Lok Sabha Debates on the Companies (Amendment) Bill as reported by the Select Committee, 16th December, 1963, Vol.XXIV, pages 4949-50).

“The votes in regard to equity holdings of trusts are misused for the purpose of concentration of economic power. What we would like to do is to free those votes completely. It will be open to the trustees to sell the shares or limit them to the extent that is mentioned or to invest in Government securities, house property or have widespread coverage even in regard to shares and not have any concentration which helps him to use his votes as a trustee along with his own to get power over a particular company.

“My purpose is not to get the right over these equity shares. Nobody wants to get the right or to get anything out of the trusts. Trust’s money can be invested within the limits of the law in each company so that it does not add to the power of the individual. If the holding of any particular trust is higher

than this limit, then we have to immobilize and freeze it. Supposing the trusts' interest are to be safeguarded, the trustee can approach the public trustee and say: my interests are to be safeguarded, what do you do about it? If the public trustee feels that the trustee is a good person, all right he says: I give you the proxy; you can act and you are only going to safeguard the interests of your trusts. But if he is not like that, if he thinks that there is ulterior intention or he suspects the bona fides of the trustees, he shall give his proxy to the one of his officers to go and exercise the vote, if he thinks it necessary in the interest of the trust. But the normal thing for the public trustee would be not to act. Abnormally, when something comes to his notice he acts either on the volition of the trustee or on his own volition. There is no intention of the Government to interfere with the property right; they only want that there is no misuse of the voting right because the trust has created certain equity shares and it adds to the aggregate economic power in the hands of the trustee who has some interest in these companies. I think I have made the position very clear. It does not have anything to do with the trust laws"

(Lok Sabha Debates on the Companies (Amendment) Bill, dated 16th December, 1963, Vol.XXIV, pages 5000-5001)

32. The object of Section 153B is obvious : To curb cases of trust which are created to enable individuals to derive personal advantage by way of control over companies. The intention of the provisions relating to trust (Sections 153B, 187A and 187B) is not to interfere in the affairs of genuine trusts but to prevent the holding of securities by trust to be used by a group of persons for the purpose of augmenting their own voting rights.

33. Clause (5) of Section 153B of the Companies Act which was introduced vide Companies (Amendment) Act, 2000 states that, *"The provisions of this section shall not apply on and after the commencement of*

the Companies (Amendment) Act, 2000.”

34. Thus, Section 153B was made inoperative with effect from the date of the commencement of the Amendment Act of 2000 i.e. December 13, 2000. Similarly the effect of Sections 153A, 187B and 187C was also nullified by the said amendment.

35. The view taken by the learned Single Judge on the interpretation of Section 153 of the Companies Act, 1956 has overlooked as aforesaid.

36. The appeal is allowed. The impugned decision dated July 04, 2013 is set aside. IA No.8673/2010 filed by the first respondent is dismissed.

37. CS (OS) No.1026/2010 is restored for adjudication on merits after issues are settled keeping in view the pleadings of the parties. The suit shall be listed for directions on April 21, 2014 before the learned Single Judge as per roster. Parties shall bear their own costs all throughout.

(PRADEEP NANDRAJOG)
JUDGE

(JAYANT NATH)
JUDGE

APRIL 03, 2014
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