

# TRANSFERABILITY OF COMPANY SECURITIES : THE NEED FOR AMENDMENT

R. S. Gae\*

## I Introduction

UNDER SECTION 82 of the Companies Act 1956 the shares in a company are movable property transferable in the manner provided in its articles of association. Articles usually empower the board of directors to refuse registration of the transfer of securities without assigning any reason. Section 111 recognises this power of refusal to register the transfer or transmission of shares or debentures and confers on the aggrieved party the right of appeal to the Central Government. Regulation 21 in table A of schedule I to the Act empowers the board to refuse registration of the transfer of a share, not being a fully paid up share, to a person of whom it does not approve. The government considered that these provisions placed an undue burden on the aggrieved person who often happened to be a small investor and that the present position regarding the transfer of securities under the Act was not conducive to the free marketability of listed securities and healthy growth of the capital market. This resulted in the enactment of section 22A<sup>1</sup> in the Securities Contracts (Regulation) Act 1956 with the object of securing free transferability of securities of public limited companies which are listed on a recognised stock exchange.

This paper suggests some amendments to the provisions of section 22A in view of practical difficulties experienced in implementing the above provisions.

## II Critical appraisal of new provisions

### (1) Transfer and registration

Broadly section 22A provides that subject to its provisions securities of companies are freely transferable. Further, it deals with registration of transfer of securities (for example, shares, debentures, bonds *etc.*) of public limited companies listed on a recognised stock exchange. The section does not affect the law relating to the transfer of securities, which are neither listed on a recognised stock exchange nor fully paid up (for example, partly paid up shares of companies) or on which the company has a lien.<sup>2</sup> Articles

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\*Senior Advocate, Supreme Court, New Delhi. Formerly Law Secretary to the Government of India.

1. Inserted by the Securities Contracts (Regulation) Amendment Act 1986 with effect from 17 January 1986.

2. See s. 22A (1) (b).

usually provide that a company has a first and paramount lien on the shares of each member for his debts and liabilities to the company and that such lien extends to all dividends payable on them.<sup>3</sup> Securities to which section 22A does not apply continue to be governed by the provisions of the Companies Act, for example, sections 82 and 111.

Refusal to register the transfer of securities by a company can now be made only on the grounds mentioned in sub-section (3) of section 22A. The board's absolute power of refusal to register under the articles of the company would no longer be available to it in view of the enactment of this provision.

## (2) Grounds for refusal of registration

Refusal to register the transfer of securities can now be made by a company on any one or more of the grounds mentioned in clauses (a), (b), (c) and (d) of sub-section (3) of section 22A and *on no other ground*. A company cannot thus refuse to register the transfer of securities on any ground other than those mentioned in the said clauses, otherwise the transfer would be *ultra vires* the provisions of the section and, therefore, void and ineffective in law. This is so notwithstanding anything contained in the company's articles or sections 82 and 111 which cannot override the provisions of the sub-section.

Grounds mentioned in clause (a) are (i) the instrument of transfer is not proper; (ii) the instrument has not been duly stamped<sup>4</sup> and executed; (iii) the certificate relating to the security has not been delivered to the company; and (iv) any other requirement under the law relating to registration of such transfer<sup>5</sup> has not been complied with.

## (3) Return of instrument for removal of technical defects

The grounds primarily relate to technical or procedural defects in the instrument of transfer. In other words, the instrument is inchoate or incomplete to effect the transfer of securities. The usual practice adopted by share departments of companies in such cases is to return the instrument to the persons concerned for removal of technical defects and its resubmission thereafter. Its return will be construed as refusal to register the transfer of securities, necessitating thereby the formation of the opinion of the company as contemplated by sub-section (4) of section 22A.

It is difficult to understand how the question of formation of the opinion of the company arises in such cases. There is apparently a distinction between the return of the instrument for removal of technical defects noticed on its scrutiny, on the one hand, and refusal to register the instrument of

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3. Regulations 9 to 11 in table A of schedule I to the Companies Act 1956 deal with the company's lien on shares held by a member of the company.

4. Instrument of transfer on which stamps have not been affixed and cancelled as required by sections 2(11), 2(12) and 2(17) of the Indian Stamps Act 1899 cannot be said to have been "duly stamped."

5. *E.g.*, the Companies Act and the Foreign Exchange Regulation Act 1973.

transfer, on the other. In the former case the stage of formation of the opinion has not been reached. When the instrument is returned for removal of technical defects, that should not be treated as refusal to register the transfer of securities within the meaning of the sub-section. This would necessitate an amendment.

Grounds mentioned in clauses (b) and (d) are that the transfer of the security is (i) in contravention of any law (for example, transfer of shares to a non-resident without the prior permission of the Reserve Bank of India under the Foreign Exchange Regulation Act 1973); or (ii) prohibited by any order of the court, tribunal or other authority under any law for the time being in force (for example, an order of the Income-tax Appellate Tribunal prohibiting the transfer of shares) respectively. Refusal to register the transfer on these grounds would also necessitate the formation of the opinion of the company as contemplated by sub-section (4).

#### **(4) Transfer of security in contravention of law or governed by prohibitory orders**

It is difficult to understand why even in cases regarding the transfer of securities in contravention of law or governed by prohibitory orders of a court or tribunal the company should be required to form its opinion, followed by a reference to the Company Law Board as provided in sub-section (4). In such cases it has no alternative but to refuse the registration, consistently with the laws applicable in the matter. The board being a quasi-judicial body cannot sit in judgment over any such matter which is *prima facie* illegal or prohibited by orders of a court or tribunal.

This would virtually result in unnecessary and avoidable paper work for the company, the transferor, the transferee and the board of directors. For the purpose, when a notice is given by the company to the transferor and the transferee regarding the contravention of law or prohibitory orders of a court or tribunal, that should be treated as sufficient compliance with the sub-section. Refusal to register the transfer of securities on the grounds aforesaid should be treated on the same footing as refusal on the ground of technical defects falling under clause (a) and should not be regarded as refusal within the meaning of sub-section (4). This too would need an amendment.

The ground mentioned in clause (c) is that the transfer is likely to result in such a change in the composition of the board of directors as would be prejudicial to the interests of the company or to the public interest.<sup>6</sup> This seems to be the only main ground which would necessitate the formation of the opinion of the company as contemplated by the sub-section.

#### **(5) Formation of opinion**

Within two months from the date on which the instrument of transfer of securities is lodged with it for registration the company must "form, in

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6. See also Companies Act, s. 250(3).

good faith, its opinion" as to whether such registration should be allowed or refused on any of the grounds mentioned in sub-section (3).<sup>7</sup> Under the Companies Act, subject to its provisions, the board of directors of a company is entitled to exercise all such powers as the company is authorised to exercise.<sup>8</sup> Hence the opinion to be formed by the company regarding registration of the transfer of securities is the opinion to be formed on its behalf by the board of directors in all cases including cases where the instrument of transfer requires to be returned for removal of technical defects under clause (a). It may not be possible for the board to meet now and then to consider cases relating to refusal to register the transfer. It is apprehended that this would unduly increase its work regarding registration of the transfer of securities, as a majority of cases of refusal to register relates to technical defects under clause (a).

If registration is to be allowed the company must do so within the period aforesaid.<sup>9</sup> Where it is to be refused on the ground of technical defects falling under clause (a), the company must within the said period intimate the transferor and the transferee by notice in the prescribed form<sup>10</sup> about the requirements of law which should be complied with for securing registration.<sup>11</sup> In case of refusal on any other ground the company must within the said period make a reference to the Company Law Board.<sup>12</sup> The board will then give to the company, the transferor and the transferee a reasonable opportunity to make their representations and thereafter pass an order allowing or refusing the registration.<sup>13</sup>

#### (6) Delegation of power regarding registration

When the company is required to form its opinion under sub-section (4) regarding registration of the transfer of securities, what is contemplated is the formation of the opinion of the board on its behalf in the matter. This aspect is left to be governed by the Companies Act. Under that Act the opinion of the company can be formed by the board (a) by a resolution passed at a board meeting; (b) by a resolution passed by it by circulation under section 289; (c) by delegation of its powers, or (d) in any other manner permissible under that Act.

The power of the company for the purpose aforesaid is normally exercised by the board by a resolution passed at its meeting. There are certain powers of the board required to be exercised under the Companies Act *only* at its meetings.<sup>14</sup> The power of the company regarding registration of the transfer

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7. S. 22A(4).

8. S. 291.

9. Cl (a) of s. 22A(4).

10. Form no. 1 prescribed under r. 3 of the Securities Contracts (Reference to the Company Law Board) Rules 1986 made under s. 22A.

11. Cl. (b) of s. 22A(4).

12. Cl. (c) of s. 22A (4).

13. S. 22A (6).

14. See, *e.g.*, ss. 262, 292, 297 (4), 299, 308, 316(2) 372 (5) and 386(2).

is not one of such powers, nor does sub-section(4) require the exercise of the power only at a board meeting. Hence besides the exercise of the power by a resolution passed at a board meeting, such power can also be exercised in any other manner permissible under the Act, for example, by delegating the power of the board to a committee of directors consisting of one or more members of its body as contemplated by regulation 77 in table A of schedule I to the Act. When a regulation in the table is not excluded, expressly or by necessary implication, it must be deemed to be incorporated in the articles.<sup>15</sup> A committee of directors as contemplated by this regulation may consist of only one director.<sup>16</sup>

The power of the company under sub-section (4) may, therefore, be delegated by the board by a resolution passed at its meeting to a committee of directors consisting of only one director, for example, wholtime director or where there is no such director, a managing director, unless the articles of the company otherwise provide. In a majority of cases this will relieve the board of the burden of calling its meetings and passing resolutions for the purpose. Such delegation will really prove useful, especially in cases where registration is to be refused on technical grounds falling under clause (a).

#### (7) Form of notice

Form number 1 prescribed under rule 3 of the Securities Contracts (Reference to the Company Law Board) Rules 1986 is the form of notice to be given to the transferor and the transferee when the company has formed the opinion that the registration ought to be refused on technical grounds falling under clause (a). In this connection it is significant to note that this form uses the expression "the company has...formed, in good faith, the opinion in its Board meeting held on...", whereas sub-section (4) states: "A company shall...form, in good faith, its opinion". The former expression cannot restrict the wide range of the latter. It is used only to indicate the ordinary procedure which may be adopted for the purpose. Surely the form prescribed for the purpose cannot control or overrule the provisions of the sub-section,<sup>17</sup> nor can it take away or whittle down the power available to the board of directors on behalf of the company to form the opinion in any other manner permissible under the Companies Act, for example, by delegating the powers of the board to a committee of directors consisting of a managing or wholtime director.

Form number 1 requires to be suitably amended<sup>18</sup> to bring it in conformity with the position under the Companies Act emerging as above. This will avoid confusion that may have arisen in the matter.

15. *Mohanlal v. Grain Chamber Ltd.*, [1968] 2 S.C.R. 252 at 262. See also Companies Act, s. 28(2).

16. *In re Fireproof Doors, Limited*, [1916] 2 Ch. 142.

17. See *Life Insurance Corporation of India v. Escorts Ltd.*, [1986] 59 Comp. Cas. 548 at 609 (S.C.)

18. Form no. 10 of appendix 1 to the Company Law Board (Bench) Rules 1975 also requires to be similarly amended.

### (8) Refusal to register in certain cases

With a view to reducing the administrative work and the mounting cost of servicing small shareholders some companies have recently amended their articles empowering the board of directors in its discretion to refuse to sub-divide, consolidate or transfer the securities into denominations below the marketable lot, where requests for the purpose appear to it to be unreasonable or without a genuine need. The marketable lot at present is 100 shares of Rs. 10 each or 10 shares, debentures or bonds of Rs. 100 each. This will prove really useful in cases where the listing agreements with stock exchanges do not allow shareholders the right to have their securities sub-divided into denominations below the marketable lot.

Refusal to register such transfer is not due to any technical or procedural defects in the instrument of transfer or due to any other requirement under "the law relating to the registration of such transfer" as contemplated by clause (a) of sub-section (3). Such refusal would be under the articles as amended. Regulations (articles) made by a company registered under the Companies Act have not the force of law and are not, therefore, "the law" as contemplated by this clause.<sup>19</sup> None of the grounds mentioned in clause (a) nor any ground mentioned in other clauses applies in the matter. Further, the articles as amended cannot override or go beyond the provisions of the sub-section.<sup>20</sup> Hence the provisions in the articles as amended empowering the board to refuse to register the transfer shall, to the extent they are repugnant to the provisions of the sub-section, be void and inoperative in law.

Section 22A may be amended by including the refusal to register the transfer as an additional ground for refusal under sub-section (3), "Marketable lot" may suitably be defined.

### III Suggestions: A sum up

To overcome the difficulties arisen in the implementation of section 22A, suggestions for amendment of the section and the forms prescribed thereunder, made above, may be summarised as follows:

*First*, where the instrument of transfer is returned for removal of technical defects falling under clause (a) of sub-section (3), it should not be deemed to be refusal to register the transfer of securities within the meaning of sub-section (4).

*Second*, the refusal to register the transfer of securities due to contravention of any law or prohibitory orders of a court or tribunal falling under clauses (b) and (d) of sub-section (3) respectively should not also be deemed to be refusal within the meaning of sub-section (4).

*Third*, the refusal to register the transfer of securities into denominations

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19. Just as regulations made by a statutory corporation have. See *Sukhdev Singh v. Bhagatram*, [1975] 3 S.C.R. 619 at 631, 642.

20. This is clear from the non-obstante clause used at the commencement of sub-section (3).

below the marketable lot should be included as an additional ground for refusal under sub-section (3).

*Fourth*, "marketable lot" for the purpose aforesaid may suitably be defined.

*Fifth*, forms numbering 1 and 10 may be duly amended to bring them in conformity with the position under the Companies Act regarding the exercise of the powers of the company by the board of directors.

If carried out, these amendments would go a long way to avoid a good deal of unnecessary paper work and expense to the company, the transferor and the transferee, and would also relieve the Company Law Board of some of the work regarding references made to it in the matter.