2012

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Anurag Tripathi* and Abhishek Chanda**

ABSTRACT

The very essence of investments made in securities is its free transferability. The process of registration of share(s) imposes a duty upon the company to scrutinize the transfer and in case of forge makes the company eligible to claim indemnity against the requester.

The paper discusses the request principle prevalent in English law at length and tries to analyse the validity of granting indemnity to companies even in cases of innocent misrepresentation without ascertaining the requester for transfer of share(s).

The paper further analyses the contrast between estoppel by representation and indemnity wherein it looks into the issue as to whether the company can claim indemnity against the bonafide person upon whose request the company transferred the share(s) if estoppel by representation is applicable against such a company?

Thereafter, the paper also sheds some light on the application of the said principle with respect to India.

Keyword- Indemnity, forged or fraudulent transfer of share(s), estoppels by representation, Innocent Misrepresentation
**INTRODUCTION**

Liquidity of share is a beneficial feature of corporation. The investor converts his investment into cash outside the company in the share market or by private sale. The company gets a permanent capital, the shareholder liquid investment. It is of the essence of incorporated companies that their shares should be transferable without any authoritative permission. The primary statutory declaration, therefore, is that shares are movable property capable of being transferred in the manner prescribed by the company’s article. The Companies Act with respect to transfer of share(s) states that ‘company shall not register the transfer of shares unless’.\(^1\) It projects the pre-conditions which must be fulfilled before effecting registration of transfer, and it is the company which has to ensure that all pre-requisite conditions are fulfilled. Therefore, it could be said that a duty has been imposed upon the company to check the entire requisite before the transfer. It cannot be negated at any cost as there have been various cases of forged or fraudulent transfer of share(s), which may be caused by the transferor or supposed transferee or company itself. The forged or fraudulent transfer of share(s) is as much the terror of modern commerce as piracy was the terror of commerce in former ages. It is settled law that forged or fraudulent transfer of share(s) does not confer any right to the supposed transferee as it is null & void, and the register is rectified.\(^2\) In such transfer, original shareholder, supposed transferee and company suffer. It is well settled that an indemnity can be granted only when there is contract.\(^3\) Therefore, the company can claim indemnity against the person upon whose request the company transferred the share(s), and the supposed transferee can claim the indemnity against the company, and the original shareholder/ supposed transferee, as the case may be, can claim indemnity, as being an

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\(^1\) Sec. 108, Companies Act, 1956 (hereinafter as CA).
\(^3\) *Texmaco Ltd. v. SBI*, AIR 1979 Cal 44.
implied contract of indemnity. However, scope of this paper is limited to cases where, after the rectification of registers, the company claims indemnity against the person upon whose request (transferor/supposed transferee) the transfer was affected, and the courts have been continuously granted indemnity irrespective of fact whether he was aware about the forgery or fraud.

The paper has been divided into two parts. Firstly, the paper analyses the request principle at length. The said principle holds the innocent misrepresentation also responsible for the act which was never intended. Secondly, the paper makes an attempt to answer the unanswered term ‘request’. It, further, discusses the contrast between the estoppel by representation and indemnity. Thirdly, the paper discusses the application of the said principle in respect of India.

The paper discusses the above mentioned scheme in the light of following questions as to whether the company can claim indemnity against the bonafide person upon whose request the company transferred the share(s) or not? If that being so, how it would be contrary to the law? Further, the paper projects lights as to whether the company can claim indemnity against the bonafide person upon whose request the company transferred the share(s) if estoppel by representation is applicable against the company in such case? Last but not the least, the paper moves towards the question as to whether the indemnity can be claimed in India after the introduction of de-mat or not? What is the law applicable in India to take care of forged or fraudulent transfer of share(s)?

The objective of this study is to evaluate the extent up to which the request principle should be modified, to identify the conflict between the request principle and estoppel by representation, to find out the law governing forged or fraudulent transfer of share(s) in India and scope of request principle after de-mat introduction.
Statement of Problem- The request principle has been applied by the court in various cases to grant indemnity against the person upon whose request the transfer took place, but the problem lies with the principle itself as it does not differentiate between the bonafide and person having knowledge about the forgery or fraud. This also does not discuss the result where the company itself is at fault and in fact, the court has granted indemnity in case where the company was at fault by not making requisite inquiry.\(^4\) The courts have been reluctant to accept principle of estoppel by representation whenever applicable in case of the company claiming indemnity. In India, demat system was introduced to avoid forged or fraudulent transfer of share(s) however, that the object does not seems to be achieved, and it can be inferred form the case of SEBI v. Rupal Panchal.\(^5\) The effect of such approach adopted by the court lead to serious consequences, wherein the company would be entitled to indemnity merely by showing that there is forged or fraudulent transfer of share(s) upon a request of the bonafide person and this is against the genesis of law.

**INDEMNITY AS A MEANS TO SHIFT THE COST**

Mere look on the name of chapter raises a question as to why it is a mean to shift the cost. To answer this question, it would be appropriate to first understand the term ‘indemnity’. The term ‘indemnity’ consists of a promise to save the promisee form loss caused by events or accidents which do not or may not depend on the conduct of any person, or from liability arising from something done by the promisee at the request of the promisor.\(^6\) A right to indemnity may be created by express/ implied contract. There is another class of cases like forged or fraudulent transfer of share(s), where the law confers a legal or equitable duty to indemnify in particular set

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\(^4\) Yeung v. Shanghai Banking Corporation, [1908] 2 All.E.R. 599.


of circumstances. To understand how it is legal or equitable duty, the paper proceeds to analysis of *Sheffield Corporation v. Barclay*, where in the court applied ‘request principle’ and held that as between two innocent parties, the loss should be borne by the respondents who caused the appellants to act upon an instrument which turned out to be invalid.

In case of *Barclay*, two persons were joint owners of stock. One of them in fraud of another forged a transfer of the stock, and borrowed money on the security of the stock. The bank sent the transfer to the corporation, and demanded that they should be registered as holder. The transfer was made in favour of the bank and the bank in its turn transferred it to holders for value. The corporation registered such holders and issued certificates. The forgery was discovered after the death of forger and the corporation had to restore the stock in favour of the surviving owner. Then the corporation sued the bank who caused them to act upon a forged transfer. The court held that the bank is liable to indemnify the corporation and opined that:

“It is a general principle of law when an act is done by one person at the request of another, which act is not in itself manifestly tortious to the knowledge of the person doing it, and such act turns out to be injurious to the rights of a third party, the person doing it is entitled to an indemnity from him who requested that it should be done. And it makes no difference that the person making the request is no aware of the invalidity in his title to make the request, or could not with reasonable due diligence have discovered it.”

Further held that:

“When a person is required to exercise a statutory duty for the benefit of person making the request, there is implied contract.”

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8 *Barclay, id.*
9 *Id.*
With due respect to their Lordships, the finding does not seem to be legally valid. I am not able to appreciate as to how mere performance of a statutory duty on request of other would suffice to make an implied contract in such a way that indemnity could be granted even where there is innocent misrepresentation or the company itself is negligent. By holding the bona fide person responsible for the consequence of fraud, the court seems unable to justify its standing as the intention to injure can’t be inferred at any cost.

I would like to propose that when a man honestly intended to do an act, the consequences cannot turn his act into fraud. There may be an obligation to see that no untrue statement is made, but the failure to meet that obligation is not fraud, if there is no dishonest intention. It would not only be sufficient to show that a false representation had been made but must be established also that the supposed transferee knew it to be untrue or have made fraudulently without it belief, at the time of representation. When a man makes an untrue statement with an intention that it shall be acted upon without any reasonable ground for believing to be true, he makes a default in a duty which was thrown upon him from the position he has taken upon himself, and he violates the right which those to whom he makes the statement have to have true statement only made to him. In case of Crawshay v. Thompson, it was held that if a wrong be done by a false representation of a party who knows such representation to be false, the law will infer an intention to injure. In case of Weir v. Bell, Lord Bramwell held that an action founded on fraud could not be sustained except by the proof of fraud in fact. In case of Smith v. Chadwick, Lindley L.J. said that fraud is proved when it is shown that a false representation has been made (i) knowingly and, (ii) without belief in its truth.

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11 Crawshay v. Thompson, 4 M. & Gr. 357; Polhill v. Walter, 3B.& Ad. 114.
13 Smith v. Chadwick, 20 Ch.D. 27.
With due respect to their Lordship, I submit that holding an innocent person responsible for innocent misrepresentation is merely not overlooking the law but completely ruling against the genesis of law. The court committed blunder by not taking into account that when a false statement has been made the questions whether there were reasonable grounds for believing it, and what were the means of knowledge in the possession of the person making it, are most weighty matters for consideration. Their Lordships also failed to mention as to how the intention to indemnify can be derived from implied contract, and in which conditions it would be appropriate to infer such intention. Suffice it to say that by not being specific, the court provided chance to the company to take benefit out of its own negligence by not making proper inquiry and holding the supposed transferee liable for injury caused by the negligence of company. This is evident from Yeung v. Shanghai Banking Corporation,\textsuperscript{14} where the company did not make the inquiry but the court upheld the indemnity claim of the company.

In case of Smith v. Chadwick,\textsuperscript{15} wherein it was held that:

“\textit{though in some respects inaccurate and not although free from imputation of carelessness, was a fair, honest and bonafide statement on the part of the defendants, and by no means expose them to action for deceit}”.

Further Barclay,\textsuperscript{16} stated that the company owes no duty to keep the register correct to the supposed transferee. By holding that the company owes no duty to the supposed transferee and enabling it to claim indemnity, the court has imposed a duty on the supposed transferee. With due respect to their Lordships, I don’t think that the ruling passes test of rule of law, equity, justice, fairness and good conscience. The Companies Act nowhere states that supposed

\textsuperscript{14} Yeung, supra note 4.
\textsuperscript{15} Id; Derry v. Peek, (1899) 14 App. Cas. 337.
\textsuperscript{16} Barclay, supra note 7.
transferee has any duty as pointed out by the court, and the word is used ‘shall’ which imposes a mandatory obligation on the company to abide by it.\(^{17}\) If this is scenario, I am not able to see the standing of court to be justified by bypassing the statute. In *Bandhua Mukti Morcha v. UOI*, the Court held that court can’t bypass the statute.\(^{18}\) If legislature had wanted to impose duty upon the bonafide transferee, it would have added in its wisdom a provision to that effect. It would be pertinent to mention that the court has acted against the legislative intent i.e. will of the WE THE PEOPLE.

Statute imposes an obligation upon company to keep register,\(^{19}\) and further when a transfer is brought to be acted upon; they do take upon itself the duty of making inquiries. When a person innocently takes a transfer to the company, it is no more than a statement by him to the following effect that “So far as I know, the transfer is genuine document. I shall leave it with you for a certain time to make inquiries, and if you find it genuine, you will receive me as a shareholder/stockholder. If on the other hand, the result of the inquiries shows it is not genuine, you will not register me as a shareholder/stockholder”.\(^{20}\)

It appears that a duty is thrown on the company to look after their own register which involves transfer of stocks or shares standing in the name of persons on the register, and that duty the company owe to those who come with transfers, and there is not any corresponding duty on the part of the person who brings the transfer, except, of course, that of bringing what he believes to be an honest. There being no negligence in the sense of want of care on either side, but there

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\(^{18}\) *Bandhua Mukti Morcha v. UOI*, AIR 1984 SC 802.

\(^{19}\) UKCA, *supra note* 17, Sec. 113 to 121; CA, *supra note* 1, Sec. 150.

\(^{20}\) *Simm v. Anglo-American Telegraph Company*, (1879)5QBD188.
being a duty on the part of company to keep the register correct and themselves to look after the transfers between innocent parties the loss must fall on the company.

**ESTOPPEL BY REPRESENTATION AND INDEMNITY**

Whenever the company files indemnity claim, it has been contended by the defendant that the company is estopped from denying the title when there was innocent misrepresentation and the act is done upon the representation of company. It does not lie in the mouth of the company to argue that it was misled by the transfer as it is duty of company to ascertain whether a transfer is valid, and if they fail to do so they must indemnify the person who thereby suffers a loss. In earlier cases, the court considered that where certificate is based on the forged or fraudulent transfer, no estoppel against the company arises in favour of the person has at least good means as the company of knowing whether the transfer is genuine, it should be deemed to have made any representation to him.\(^{21}\) A person who presents a transfer to a company for registration, whether it is in favour of himself or someone else (a broker presenting a transfer on behalf of his or her client) impliedly warrants that it is genuine, and if it is not, may be liable to company if it suffers loss by acting on it.\(^{22}\)

But there has been change in this aspect of law which may be drawn from *Cadbury Schweppes PLC v. HS Dealing*,\(^{23}\) because the court considered the argument advanced in favour of estoppel rather than request principle. It was held that:

> “This exception requires qualification in the case of reliance upon an erroneous statement in a share certificate issued by the company. Ordinarily, a person who presents a share transfer for registration is required to indemnify the company against any liability it incurs to other persons

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\(^{21}\) Id.


\(^{23}\) *Cadbury Schweppes PLC v. HS Dealing*, [2006] EWHC 1184 (Ch).
as a result of registering the transfer. However, where the person presenting a share certificate for registration relied upon an erroneous statement of ownership on a share certificate, the estoppel raised against the company overrides the company’s right to an indemnity.”

The power of granting certificates is to give the shareholders the opportunity of more easily dealing with their shares in the market by showing a marketable title, which increases the liquidity of shares. Therefore, such power is for the benefit of the company in general; and it is given by the company with the intention to be used by the concerned person, and acted upon in the sale and transfer of shares. If the supposed transferee has acted bona fide, and did all that is required of purchasers of shares. It turned out that the transferors had in fact no shares, or given them certificates, the transfer to them being a forgery. That brings the case within the principle of the decision in *Pickard v. Sears*,\(^2^4\) that if you make a representation with the intention that it shall be acted upon by another, and he does so, you are estopped from denying the truth of what you represent to be the fact.

There is no reason why the estoppel by representation should not be deployed. The onus is on the Companies to displace the prima facie title which their own share certificates conferred.\(^2^5\) Thus the company is unable to deny the truth of their own share certificates naming others as the shareholders at the only time at which the Stockbroker/bonafide supposed transferee did anything of relevance, find themselves unable to assert or prove that the persons they reinstated were, indeed, the true shareholders. The Companies have no right to claim indemnity against the Stockbrokers/ bonafide supposed transferee.\(^2^6\)

\(^{2^4}\) *Pickard v. Sears*, 6 AD&E 469; *Freeman v. Cooke*, 2 Ex 654.

\(^{2^5}\) *Dixon v. Kennaway*, [1900] 1 Ch 833.

\(^{2^6}\) Royal, *supra note*, 22.
There is no reason to presume that the Stockbroker/ bonafide purchaser would have known falsity of the certificates at time of presenting it for share(s) transfer because one can rely upon the truth presented by the company. There is no wrong by the Stockbrokers/ bonafide supposed transferee from which they seek to profit and the principle that a man must not be permitted to profit from his own wrong is not one that is intended to deny an estoppel to an innocent party who seeks not his own profit nor the profit of the wrong-doer but merely to avoid a loss. Even if the said principle is to be applied, it is the company committing wrong by issuing certificate at its sweet-will without due care and it has already been established that trading in shares is beneficial for the company. Therefore, I am not able to appreciate the fact that instead of holding the company responsible which deriving benefit from its wrong, the stockbroker/ bonafide supposed transferee has been held responsible. Nothing could be far from the justice, equity and fairness.

The principle in *Barclay*[^Barclay27] states ‘benefit for the person making the request’. The determination of fact as to who made request becomes essential otherwise there is no basis to indemnity claim. The courts have said that the broker made the request and hence, liable to indemnify the company.[^Yeung28] With due respect to their Lordships, I am not able appreciate as to why the court continued to grant indemnity without properly finding as to who made the request. Their Lordships could not satisfactorily state as to how merely forwarding the duly share transfer form, which was handover to the broker, could amount to request. It is merely notice to the company with respect to the share(s) transfer, and receives small fee of one guinea for his trouble. In reason, there is no ground for the interference that he acts as agent or request the company to allow the transfer as it is sole discretion of company to register the transfer. The broker acts merely as witness, and really as agent for anybody, in the matter, but if he does as agent, he acts

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[^Barclay27]: Barclay, supra note 7.
[^Yeung28]: Yeung, supra note 4; Royal, supra note 22.
as agent for the company. Assuming but not conceding, such notice could amount request then still a huge question left as to how it is beneficial to the stockbroker. With due to their Lordships, I submit that they did not bother to keep in the mind that the request is not a fact, but an inference of law from the facts.29

INDEMNITY FOR FORGED OR FRAUDULENT TRANSFER OF SHARE(S) IN INDIA AFTER INTRODUCTION OF DE-MAT

In India, dematerialization was introduced through Depository Act, 1996 to avoid certain irregularities like forged or fraudulent transfer of share(s). However, the purpose of Depository Act, to take care of forged or fraudulent transfer of share(s), is not achieved till now. Recently in January 2012, SEBI decided the case of SEBI v Rupal Panchal,30 and a penalty was imposed under Sec. 15HA of the SEBI Act. In this case, the key operators or master account holders had opened large number of de-mat accounts and bank accounts which were in the names of non-existent persons/benami and they acquired shares of various companies in the IPOs by making applications in fictitious/benami names with each of the application under the retail category. The shares from the de-mat accounts of such fictitious/benami allottees were transferred in the de-mat account of key operators/master account holders before the listing of such shares on stock exchange(s). The key operators then transferred the shares through off market deals to financiers of this scheme or arrangement to corner shares from the quota reserved for retail investors in the IPOs of various companies and in some cases they retained a portion of shares for themselves. The shares so retained by them were sold in the market with huge ill-gotten gains.

In India, such activities are treated as fraudulent and unfair trade practices, and thereby regulated by Sec. 12A read with 15HA of SEBI Act, Reg. 3 read with 4 of the SEBI (Prohibition of

30 Rupal Panchal, supra note 5.
Fraudulent and Unfair Trade Practices relating to the Securities Market), Regulation, 2003.\textsuperscript{31} For the purpose of de-mat transaction, Sec. 152A of Companies Act mentions that the register and Index of beneficial owners maintained under Sec. 11 of the Depository Act shall be deemed to be an index of member and register for the purpose of this Act.\textsuperscript{32} Proviso of Sec. 51 of the Companies Act provides that index of member to be served to the Company.\textsuperscript{33} Further, Sec 151 imposes a duty upon the company to alter the index of member whenever required.\textsuperscript{34} Sec. 108(3) of the Companies Act mentions that nothing contained in that Sec. would apply in case of dematerialised transaction where the transferor and transferee are entered as beneficial owner in the record of depository, therefore there is no requirement of a proper instrument of transfer duly stamped and executed by or on behalf of transferor and by or on behalf of transferee, etc.\textsuperscript{35} In case of de-mat transaction, Intra/Inter Depository Slip is filled and thereby a request is made to the company to effect the transfer of share(s).\textsuperscript{36} In case of forged or fraudulent transfer of share(s), as per Sec. 111(A) of the Companies Act, an application may be made by a depository, company, participant or investor or SEBI and there being a transaction contrary to the provision(s) of SEBI Act, the court may direct the depository or company to rectify its register or record. Even if the direction is given to the depository but still as per Sec. 151 of the Companies Act, the Company has to alter its index of member, thereby the company may claim indemnity against the person upon whose request the company was transferred the share(s) on the basis of implied contract because as there is no contract, except implied one, which may provide indemnity against the loss suffered by forged or fraudulent transfer of share(s). In addition to

\begin{footnotes}
\item[31] Sec. 12A read with 15HA, SEBI Act, 1992; Reg. 3 read with 4 of the SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to the Securities Market), Regulation, 2003.
\item[32] CA, supra note 1, Sec. 152A; Sec. 11, The Depository Act, 1996 (hereinafter as DA).
\item[33] CA, id., Sec. 51.
\item[34] Id., Sec. 151.
\item[35] Id., Sec. 108(3).
\end{footnotes}
this, further to take care of the interest of beneficial owner, Sec. 16(1) read with (2) of the Depository Act provides that any loss caused to the beneficial owner due to the negligence of the depository or the participant, the depository shall indemnify such beneficial owner. Therefore, the beneficial owner can claim indemnity against the depository/participant as this being statutory indemnity and against company as per implied contract.

Even after the introduction of de-mat transaction, there is scope of physical transaction. Sec. 8(1) of the Depository Act, provides that person subscribing to securities offered by an issuer shall the option either to receive the security certificate or hold securities with a depository.\(^{37}\) Sec. 68B of the Companies Act, provides that every listed public company making IPO of any security for a sum of ten crores or more, shall issue the same only in dematerialised form,\(^{38}\) therefore an IPO having value of less than 10 crores is not to be issued in dematerialised form. In such a case, Sec. 108 to 112 of the Companies Act read with R. 3 of the Companies (Compliance Certificate) Rules shall apply for the transfer of share(s) and it nowhere states that the transfer of share(s) is registered on an application with the indemnity, except in case where the transfer deeds reported lost. Therefore, in case of forged or fraudulent transfer of share(s), the company may claim indemnity against the person upon whose request the company transferred the share(s) on the basis of the implied contract.

**CONCLUSION**

The request principle could be said to have been good starter but due evolvement of time, it is would be pertinent to modify the said principle keeping in the mind the innocent misrepresentation as well as the negligence on the part of company. The said principle must

\(^{37}\) DA, supra note 32, Sec. 8(1).
\(^{38}\) CA, supra note 1, Sec. 68B.
exclude the bonafide representation and the court must consider the term ‘request’ and ‘type of benefit from such request’, which it has continuously opted not to consider even in slightest mode what to say about exhaustive consideration. The courts have made it as objective test rather than making it subjective. It is this crucial point which has led to miscarriage of justice. If one goes as per request principle and the bonafide transferee has requested, he is in general the worst sufferer from the forged or fraudulent transfer of share because the original shareholder would get shares and the company would be indemnified.

It is clearly beyond any doubt that when We The People repose their confidence in the court, the court must redeem their confidence. By shifting the duty of company upon the people and making them liable for the negligence of the company nowhere suggest that confidence is redeemed. The company must at its peril ascertain whether a person demanding to transfer share is entitled to do so, for which purpose they are entitled to a reasonable time for making inquiries.

It is an appropriate time that while applying the request principle, the court should consider the estoppel by representation whenever applicable. It should be remembered that after 1991, there has been shift of power from the state to the corporation and providing such opportunity to corporation would necessarily lead to miscarriage of justice. Therefore, it is of utmost importance that the request principle must be modified and principle of estoppel by representation must be applied whenever applicable because one should not be allowed to take the benefit of its own wrong.

Even after such laws as above mentioned, in India, forged or fraudulent transfer of share(s) have not been avoided totally, and there is scope of physical transfer of share(s) also. In such case, when the company suffers the loss, the company can claim the indemnity against the person
making request upon whose request the company transferred the share on the basis of *request principle* as there is an implied contract.

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