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Investigations

National and individual savings constitute the chief source of capital formation in a democratic country, and is, therefore, vital to economic growth.[1] Incorporated enterprise is one of the methods of allocating and channelling limited capital resources.[2] The proper functioning, that is to say, a performance that will ensure adequate return on capital, is ultimately the best protection of those who provide capital.[3] "Efficient functioning" can be assured by preventing corporate abuses and wrongs.

Corporate managements are today free from many of the former restraints. For example, the doctrine of *ultra vires* is no longer any significant check upon corporate spending.[4] Again, the powers of management are vested in the board to the total exclusion of shareholders.[5]

> The shareholder has become an investor, separated in time and understanding, insulated by distance and the proxy machinery from the business activities of the enterprise. The reality of the internal corporate structure has changed from democratic to bureaucratic.[6]

Hence the shareholder is no longer available as an adequate field of responsibility.[7] "Due to great diffusion of stock, shareholders become indifferent to voting and controlling."[8] It is an "illusion that anything like an effective control of the shareholders over the management of a big company can be re-established. The divorce between financial interest and power of management is a fact."[9] "Further the shareholders are ill-equipped to challenge the wisdom and expertise of officers."[10]

Accordingly any remedies against corporate abuses that have to depend for their effectiveness upon shareholder initiative are not likely to be very successful. "The law suit against management is an uncertain road, open only in relatively extreme cases of perfidy and subject to heavy toll charges in the form

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1 *See* Hsiu-Kwang Wu, *An Economist Looks at S. 16 of the Securities Exchange Act, 1934*, (1968) Col LR 250 at 269.

2 *Ibid.*

3 Louis Loss, *The Fiduciary Concept as Applied to Trading by Corporate Insiders*, (1970) 33 Mod LR 34.

4 *See* R. C. Beuthin, *The Ultra Vires Doctrine — An Obituary Notice*, (1966) 83 SALJ 461; James William Hurst, *The Legitimacy of the Business Corporation in the Law of United States*, 1780-1970, (1970) Col LR 1317, 1318.

5 *See* Powers of Directors, *Ante*.

6 Abraham Chayes, *The Modern Corporation and the Rule of Law*, in E. S. Mason (Edn), THE CORPORATION IN MODERN SOCIETY, 25, 40 (1959). *See* also J. A. Livingstone, THE AMERICAN STOCKHOLDER, at 38, where the learned writer says: "The stockholders are investors, who for the most part, do not wish to be bothered except by dividends."

7 A. A. Berle, THE 20TH CENTURY CAPITALIST REVOLUTION (1954).

8 Henry G. Manne, *The Higher Criticism of the Modern Corporation*, (1962) 62 Col LR 399. *See* also Emerson and Latchem, SHAREHOLDER DEMOCRACY, (1954).

9 O. K. Freund, *Company Law Reform*, (1946) 9 Mod LR 235 at 245.

10 A. A. Berle Jr, *Legal Problems of Economic Power*, (1960) 60 Col LR 4.

of lawyer's fee."[11] Remedies afforded by the exceptions to the rule in *Foss* v *Harbottle*[12] and Sections 397 and 398 for prevention of oppression and mismanagement are beset with a variety of procedural and financial hurdles.[13]

"The reality of control can only be found in the action of public opinion and in the organised supervision exercised by Government agencies. Hence the importance of investigations."[14]

"There is no doubt that few shareholders have the means or ability to act against the management. It would furthermore be difficult for the shareholders to find out the facts leading to the poor financial condition of a company. The Government thought it right to take power to step in where there was reason to suspect that the management may not have been acting in the interests of the shareholders.... and to take steps for the protection of such interests (the Act) gives the exploratory power."[15]

Powers of investigation

"Sections 235 to 251 provide for investigation of the affairs of a company."[16] The power is split into two sets, one containing mandatory and the other permissive provisions.

Mandatory Provisions

Under the first part of Section 237 the Government is bound to appoint inspectors to investigate the affairs of a company in the following two cases:

1. When the company by a special resolution demands an investigation, and
2. When the court, by order, declares that the affairs ought to be investigated by an inspector appointed by the Central Government.

There is no guidance in the Act as to who can seek the order of the court for this purpose. The Gujarat High Court has held in *Alembic Glass Industries Ltd, Re*,[17] that the power of the court is not subject to the provisions of Section 235 or 237*(b)*:

> The Legislature in its wisdom has not put any such condition before the court can make an order, though the court may in its wisdom expect *prima facie* proof of some of these conditions. While conferring jurisdiction on the court to direct the Central Government to appoint an inspector, the Legislature have not thought fit to circumscribe the discretion or jurisdiction in any manner. It would, therefore, be utterly inappropriate to curtail or

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11 J. A. Livingstone, THE AMERICAN STOCKHOLDER, quoted at 1483 of (1958) 67 Yale LJ 1476. The problem of expenses and the possible solutions therefor are discussed in A. J. Boyle, *Indemnifying the Minority Shareholder*, 1976 JBL 18.

12 (1843) 67 ER 189: (1843) 2 Hare 461.

13 Henry G. Manne, *The Higher Criticism of the Modern Corporation*, (1962) Col LR 399, 410.

14 O. K. Freund, *supra*, fn 9, 246.

15 MUDHOLKAR J in *Barium Chemicals Ltd* v *Company Law Board*, [1966] 2 Comp LJ 151, 161: AIR 1967 SC 295: (1966) 36 Comp Cas 639.

16 *Ibid.*, HIDAYATULLAH J (afterwards CJ) at 164.

17 (1972) 42 Comp Cas 63 Guj.

circumscribe or fetter the jurisdiction of the court by reading into the section something which is not there.[18]

Even so it seems that the courts would insist upon "solid factual base for the appellant's suspicions, rather than a mere feeling that something is wrong".[19] The material placed before the Tribunal must be such as to justify an order for deeper probe into the affairs of the company.[20] In *Miles Aircraft Ltd, Re, (No. 2)*[21] a company, having suffered a loss of nearly one million pounds in a year, declared 7-1/2 per cent dividend. This was held to be sufficient to warrant an order for investigation.[22] Delhi High Court[23] has expressed the opinion that the person seeking an order must be able to show some manner of interest in the concern. It would not be correct to read the section as authorising any man in the street to seek an order for investigation. The court accordingly rejected the application of the landlord of the company who wanted investigation on the grounds that he had paid a sum of money to the managing director to induce him to vacate the premises and he misappropriated the money, or that he was using his political contacts for promoting business or that he had misappropriated the money borrowed by the company from banks. Citing a passage from a decision of the House of Lords[24] the court said that the section should be so interpreted as to enable relief to be obtained only by some person whose rights have been affected by the manner in which the affairs of the company have been conducted or accounts maintained and has, therefore, a grievance in the eyes of law.[25]

Discretionary or Permissive Provisions

Such provisions are to be found partly in Section 235 and partly in Section 237(*b*).

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18 D. A. DESAI J at 68, *ibid.*

19 R. D. Fraser, *Administrative Power of Investigation into Companies*, (1971) 34 Mod LR 260, 261. Observations in management audit report without any corroborative evidence cannot be taken up for seeking an order of the Company Law Board for investigation of the affairs of the company. *AP State Civil Supply Corpn Ltd* v *Delta Oils & Fats Ltd*, [1997] 3 Comp LJ 146 (CLB-PB).

20 *AP State Civil Supply Corpn Ltd* v *Delta Oils & Fats Ltd*, [1997] 3 Comp LJ 146 (CLB-PB).

21 [1948] WN 178.

22 *Id.* at 260-61.

23 *V. V. Purie* v *E. M. C. Steel Ltd*, (1980) 50 Comp Cas 127 Del.

24 *Gouriet* v *Attorney General*, [1977] 3 WLR 300. *See* further *Kumarunni Mathrubhumi Printing & Publishing Co, Re*, (1983) 53 Comp Cas 370 Ker; *P. Srinivasan* v *Y. S. A. & Sons*, (1983) 53 Comp Cas 485 Ker; *U. A. Sumathi* v *Dig Vijay Chit*, (1983) 53 Comp Cas 493 Ker.

25 No interim relief can be provided in such orders. Such relief is in the nature of a step-in-aid and, therefore, can be allowed only when the court is required to make a final adjudication. An investigation is only a fact-finding mission. *Ilunet India Ltd* v *ICRAO*, (1995) 17 Corpt LA 192 AP. The power of the High Court and that of the Company Law Board being concurrent, it has been held that the statutory remedy of approaching the Company Law Board should be exercised before asking the High Court to exercise its discretionary power. The court also said that directors against whom there are allegations of mismanagement should be parties. *Safia Usman* v *UOI*, 22 SCL 372 (Ker).

Section 235 enables the Central Government and the Tribunal to appoint inspectors for investigation in the following cases:

1. *On Members' Application*

   (*a*) On the application of two hundred members, or members holding one-tenth of the total voting power.

   (*b*) Where the company is without share-capital, on the application of one-fifth of the members.[26]

"When members apply they must support their application by evidence and the Company Law Board [now Tribunal] may ask them to give security for costs of investigations."[27] The evidence must show "that the applicants have good reason for requiring the investigation". The amendment of 1988 has made this alteration that application under this part of Section 235 has to be made to the Tribunal. The Tribunal will give an opportunity to the parties of being heard. The Tribunal may then declare that the affairs of the company ought to be investigated. On such declaration being made, the Central Government has to appoint one or more competent inspectors to investigate the affairs of the company and to submit a report thereon in such a manner as the Government may direct.[28]

2. *On Report by Registrar under Section 234*

This section confers on the Registrar the jurisdiction to call for information or explanation in relation to any document submitted to him.[29] If the information or explanation is not furnished or is unsatisfactory the Registrar can make a report to the Central Government for necessary action.[30] Secondly, if a contributory or creditor, or other person interested, places materials before the Registrar: (*a*) that the business of the company is being carried on in fraud of its creditors or of persons dealing with the company or (*b*) otherwise for a fraudulent or unlawful purpose, the Registrar can, after hearing the company, call upon it to furnish any information or explanation.[31]

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26 As shown by the company's register of members, S. 235(*b*).

27 Not exceeding Rs 1000. The power can be exercised by the Central Government after a proper preliminary enquiry. It cannot be exercised simply on the basis of allegations. *Ramesh Motor Transport Ltd* v *Tadi Adinarayana Reddy*, (1997) 25 Corpt LA 177: (1997) 90 Comp Cas 383 SC. The party in this case had gone directly under writ jurisdiction which was not allowed. *Tadi Adinarayana Reddy* v *UOI*, (1997) 90 Comp Cas 376 affirmed in *Tadi Adinarayana Reddy* v *UOI*, (1997) 90 Comp Cas 376. Thus the power under S. 235 or S. 237 can be exercised either through the Company Law Board or the Central Government but not directly under writ jurisdiction. The jurisdiction cannot be diverted to the High Court even if some matters of public interest are involved. The Company Law Board is competent for the purpose. The Department of Company Affairs is supposed to be an expert body in company law matters. Therefore the standard under S. 237(*b*) has to be that of an expert. The Company Law Board jurisdiction is of exclusive nature. Consumer Protection Forums are also excluded. *Chandrika Prasad Sinha* v *Bata India Ltd*, (1997) 88 Comp Cas 81 CLB. The conduct of the petitioning shareholder is not relevant to this power. The petitioner had made out a case for investigation, his conduct, good or bad was irrelevant. *Chandrika Prasad Sinha* v *Bata India Ltd*, (1997) 88 Comp Cas 81 CLB.

28 S. 236.

29 S. 234(1). The information or explanation is required to be submitted on the pain of penalties. *See* sub-section (4).

30 S. 234(6).

31 HIDAYATULLAH J (afterwards CJ), in *Barium Chemicals Ltd* v *Company Law Board*, [1966] 2 Comp LJ 151, 164: AIR 1967 SC 295: (1966) 36 Comp Cas 639.

"A further power is conferred on the Registrar, who may, after being authorised by a Presidency Magistrate or a First Class Magistrate, enter any place, search or seize any document relating to the company, or its managerial personnel, if he has reason to believe that it may be destroyed or tampered with."[32] On receiving a report from the Registrar the Central Government may appoint inspectors.

3. *On discretion of Tribunal*

Section 237(*b*) lays down three cases in which the Tribunal can appoint inspectors on its own motion. The section empowers the Tribunal to ask the Government to act if there are circumstances suggesting the following:

(*a*) *Fraud, Oppression or Illegality*

That the business of the company is being conducted with intent to defraud creditors, members or any other person, or for a fraudulent or unlawful purpose, or in a manner oppressive to certain members, or that the company was formed for any fraudulent or unlawful purpose. The CLB (now Tribunal) ordered under this clause, with a view to end oppression, the oppressing group of shareholders to purchase the shares of the complaining group.[33]

(*b*) *Fraud, Misfeasance or Misconduct*

That the persons concerned with the formation of the company or management of its affairs have been in connection therewith, guilty of fraud, misfeasance or other misconduct towards the company or towards any of its members.[34]

(*c*) *Inadequate Information*

That the members of the company have not been given all the information with respect to its affairs which they might reasonably expect including information as to commission payable to the managing director or manager.[35]

The concepts emphasised by the provision are nothing new to company law. The phrase "intent to defraud creditors" has already been judicially construed under Section 542 which imposes liability for fraudulent conduct of business.[36] The word "oppressive" has been construed in a number of cases under Section

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32 *Ibid.*

33 *Kuki Leather P Ltd* v *TNK Govindaraju Chettiar & Co*, (2002) 110 Comp Cas 474 Mad. The Civil Procedure Code, being not wholly applicable, a compromise between the parties was held to be effective though not signed as required by CPC.

34 *Incab Industries Ltd. Re*, (1996) 23 Corpt LA 245 CLB, diversion of funds and project money, laxity in collection of loans, payment of commission without justification, wasteful expenses, investigation ordered.

35 Where the allegations related to reservation in issues in favour of foreign investors and the same was approved by the shareholders and the Government bodies at various stages and all the approvals were obtained with total transparency, an order of investigation could not be made. *Chandrika Prasad Sinha* v *Bata India Ltd*, (1997) 88 Comp Cas 81 CLB.

36 See *William C. Leitch Bros Ltd, Re*, [1932] 2 Ch 71: [1932] All ER Rep 892; *Nagendra Prabhu* v *Popular Bank*, AIR 1970 Ker 120: (1969) 39 Comp Cas 685: ILR [1969] 1 Ker 340 and *Maidstone Buildings Provisions, Re*, [1971] 1 WLR 1085.

397 including the decision of the Supreme Court in *Shanti Prasad Jain* v *Kalinga Tubes Ltd*[37] and the same meaning is likely to be attached here.

Referring to the words "fraud, misfeasance or other misconduct" a learned commentator says:

> These seem to be words of very wide import: in *Selangor United Rubber Estates Ltd* v *Cradock*[38] Goff J held, withdrawing some of his dicta in an earlier case,[39] that "other misconduct" is not to be construed *ejusdem generis* with "fraud" and "misfeasance" and that the statutory wording quoted above does not include "moral turpitude". In view of this, it seems that [the] section... [would] extend to what was called in *B. Johnson & Co, Re*,[40] "common law negligence". The Board of Trade, however, are of opinion that this head does not include mere managerial inefficiency.[41]

Observations in a management audit report which were not substantiated by any evidence could not be taken up for seeking an order of investigation.[42] Failure in finalisation of accounts for over five years has been held sufficient evidence for supporting an order of investigation.[43]

The power is only to make a declaration that the affairs of the company ought to be investigated and not to direct an investigation.[44]

Manner of exercising Discretion

"These grounds limit the jurisdiction of the Central Government."[45] The Government (now Company Law Board) does not have "a general discretion to go on a fishing expedition to find evidence".[46] An order for investigation can be justified only if the circumstances exist which suggest an inference of the enumerated kind. Explaining the scope of the Government's power (now Tribunal) in *Barium Chemicals Ltd* v *Company Law Board*, HIDAYATULLAH J (afterwards CJ) said:[47]

> No doubt the formation of opinion is subjective... (but) the existence of "circumstances" is a condition fundamental to the making of an opinion, the existence of circumstances, if questioned, has to be proved at least *prima facie*. It is not sufficient to assert that the circumstances exist and give no clue to what they are because the circumstances must be such as to lead to conclusions of certain definiteness. The conclusion must relate to an intent

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37 [1965] 1 Comp LJ 193: AIR 1965 SC 1535: (1965) 35 Comp Cas 351.

38 [1967] 1 WLR 1168.

39 *S. B. A. Properties Ltd* v *Cradock*, [1967] 1 WLR 716: [1967] 2 All ER 610.

40 1955 Ch 634, 648. Lord EVERSHED MR.

41 Minutes of Evidence to the Jenkins Committee, para 6946. The learned commentator is R. D. Fraser, *Administrative Power of Investigation into Companies*, (1971) 34 Mod LR 260 at 262.

42 *A P State Civil Supply Corpn Ltd* v *Delta Oils & Fats Ltd*, (1999) 96 Comp Cas 303: [1997] 2 Comp LJ 146 CLB.

43 *Essar Usha Corpn* v *Richmen Silks Ltd*, (1999) 21 SCL 137: (1999) 34 CLA 336 CLB.

44 *Safia Usman* v *UOI*, (2002) 110 Comp Cas 710 Ker.

45 HIDAYATULLAH J (afterwards CJ) in *Barium Chemicals Ltd* v *Company Law Board*, [1966] 2 Comp LJ 151, 167: (1966) 36 Comp Cas 639: AIR 1967 SC 295.

46 *Ibid*

47 *Id.* at 168.

to defraud, a fraudulent or unlawful purpose, fraud or misconduct or the withholding of information of a particular kind. We have to see whether the Chairman[48] in his affidavit has shown the existence of circumstances leading to such tentative conclusions. If he has, his action cannot be questioned because the inference is to be drawn subjectively and even if this Court would not have drawn a similar inference that fact would be irrelevant. But if the circumstances pointed out are such that no inference of the kind stated in Section 237*(b)* can at all be drawn the action would be *ultra vires* the Act and void.

The facts of the case were as follows:

> The Secretary of the Company Law Board issued an order on behalf of the Board under Section 237*(b)* appointing four persons as inspectors to investigate the affairs of the appellant company. The order was challenged on several grounds. Two of the grounds were that the order was mala fide and that the Board had acted on materials extraneous to Section 237*(b)*. The Chairman in his affidavit alleged that there was delay, bungling and faulty planning of the project entailing double expenditure, continuous losses resulting in one-third of the share capital being wiped out, shares being quoted at half their face value and severance of their connection by some eminent persons.[49]

The Supreme Court held that these circumstances "cannot by themselves suggest an intent to defraud or fraudulent management.... Mere bungling or faulty planning cannot constitute either misfeasance or misconduct."[50]

Similarly, where the management of a company acquired the shares of its subsidiary of Rs 10 each at a premium of Rs 100 and offered them to the members in lieu of cash dividends and 99% of them opted for the shares; made a loan of a huge sum to its subsidiary at 2%, though it was not justified by commercial expediency; these were held to be not suggestive of fraud as to warrant an order of investigation.[51]

In another case the allegations that there had not been adequate and proper audit of accounts, as the auditor's reports were based on defective information and that the auditors were not independent, were held insufficient to found an order,[52] particularly when it appeared that knowledge of these facts was acquired after making the order. Similarly, where it was alleged that shares were sold for inadequate consideration, an order for investigation failed

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48 The Chairman of the Company Law Board. "The Board was constituted on February 1, 1964, by a notification and by a notification of even date in the exercise of the powers conferred by clause *(a)* of sub-s. (1) of S. 637, read with sub-section (1) of S. 10-E of the Companies Act, the Central Government delegated its powers and function to the Board under S. 237*(b)* among others." See HIDAYATULLAH J (afterwards CJ), *ibid*, 165.

49 See the judgment of SHELAT J at 188-189.

50 *Ibid.*

51 *Jiyajee Rao Cotton Mills* v *Company Law Board*, [1969] 2 Comp LJ 380 MP; *Ashoka Marketing Ltd* v *UOI*, (1981) 51 Comp Cas 634 Delhi, involving similar charges.

52 *New Central Jute Mills* v *UOI*, AIR 1970 Cal 183: (1970) 40 Comp Cas 102: [1969] 2 Comp LJ 32.

as it appeared that no prior effort had been made to ascertain the market value of the shares and to compare it with the value obtained by the company.[53] The Court said: "The fact that one of the directors (though influential) was suspect is irrelevant." The statement of the Government that general meetings were not properly held, excess of application money was not refunded, refundable money placed in some other bank, money not used for purposes stated in the prospectus were held to be making out a ground for investigation.[54]

This line of cases shows that the courts have taken rather a strict view of the power conferred by Section 237. Explaining the reasons, HEGDE J said:[55] "In interpreting Section 237(*b*) we cannot ignore the adverse effect of the investigation on the company.... We must also remember that the section in question is an inroad on the power of the company to carry on its trade or business and thereby an infraction of the fundamental rights guaranteed to its shareholders under Article 19(1)(*g*)." The court may not order an inquiry into the economic functioning of the company. In a case before the Delhi High Court[56] the alleged grounds were a successive fall in profits, directors' relatives were appointed to high positions and on high salaries, creation of a subsidiary company with mainly the directors' relatives and employees and loans to the subsidiary on which no interest had been realised. The court dismissed the petition with the remark that even if all these facts were supposed to be true, the truth was floating on the surface and, therefore, what was to be investigated? "An investigation is necessary to discover something which is not apparently visible to the naked eye."

But subject to these considerations the "order of the Company Law Board (now Tribunal) under Section 237(*b*) is not justiciable when it is reasonably made *bona fide* even though the reasons given do not appeal to a court of law."[57] Thus where the Central Government (now Tribunal) came to hold the opinion that the working results and the rates of dividend declared were incompatible, an order for investigation was held to be justified.[58]

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53 *Rohtas Industries* v *S.D. Agarwal*, (1969) 1 SCC 325: (1969) 39 Comp Cas 781: [1969] 1 Comp LJ 350. Loss of some share certificates in the office of the company and irregularity in issuing duplicates has been held not sufficient. *Charanjit Singh Ghuman* v *Dr Reddy Laboratories Ltd*, (1997) 25 Corpt LA 204 CLB.

54 *Premier Plantations Ltd* v *M Ebrahim Kutty*, (2002) 110 Comp Cas 721 Ker.

55 *Rohtas Industries* v *S.D. Agarwal*, (1969) 1 SCC 325: AIR 1969 SC 707: (1969) 39 Comp Cas 781: [1969] 1 Comp LJ 350.

56 *Delhi Flour Mills Ltd, Re*, (1975) 45 Comp Cas 33 Delhi.

57 *See* the judgment of the Calcutta High Court in *Ashoka Marketing Ltd* v *UOI*, [1966] 1 Comp LJ 267 and the judgment of SHELAT J in the *Barium Chemical* case.

58 *Ibid. See* also *New Central Jute Mills* v *Dy Secretary, Ministry of Finance*, [1964] 2 Comp LJ 152; *Raja Narayanalal Bansilal* v *Manick Phiroze Mistry*, AIR 1961 SC 29: (1960) 30 Comp Cas 644; *Patrakala Tea Co Ltd, Re*, [1966] 2 Comp LJ 177 Cal; *Ashoka Marketing Ltd* v *Company Law Board*, [1968] Comp LJ 190: (1968) 38 Comp Cas 519 Cal. *See* also *Norwest Holst Ltd* v *DTI*, The Times, February 2, 1978, noted 1978 JBL 179.

The appointment of inspectors puts the company's management under a cloud. Even so natural justice is not applicable. Lord DENNING, MR said that individual shareholders often in practice had little control over the company's affairs, the directors were often a self perpetuating hierarchy. The Department's power to appoint inspectors should be seen as a substitute for inadequate shareholder control, and consequently courts should not fetter

The Company Law Board (now Tribunal) should not hold back from the court (now Appellate Tribunal) the circumstances which suggested the necessity for an investigation. An order cannot be upheld if the circumstances are not disclosed particularly where no privilege is claimed in respect of such materials.[59] In one of the cases,[60] an inspector, having been appointed on allegations of fraud, could not complete his work even after securing three extensions. He was then relieved by two new inspectors and the investigation was continued for nearly 15 months. When the order was challenged, the Government failed to disclose any facts on which they had proceeded. Their attitude was best described by MITRA J's words:

> The appellants closed and bolted the door. They drew the veil tightly around them, and they thought that the veil can neither be pierced nor lifted to see if materials exist which the statute requires as to be a precondition to the making of an order.

Where a Government corporation had majority in the company's Board of directors and, therefore, it could have carried out a special audit and adopted remedial measures, if necessary, an order of investigation into affairs was considered to be not necessary.[61]

Powers of inspectors [S. 240]

Where an inspector investigating the affairs of a company thinks it necessary to investigate the affairs of another company in the same management or group, he is empowered to do so. However, in some cases mentioned in Section 239(2), he has to obtain prior approval of the Central Government for that purpose.[62] Section 240 has been amended by the Amendment of 2000. Sub-section (1) was substituted. The new sub-section provides that it shall be the duty of all officers and other employees and agents of the company and those of any other body corporate whose affairs are being investigated under Section 239:

> (*a*) to preserve and to produce to an inspector or any person authorised by him in this behalf with the previous approval of the Central Government, all books and papers of or relating to, the company or, as the case may be, of or relating to the other body corporate, which are in their custody or power; and

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investigations that might be the only machinery available for keeping the public interest intact and seeing that companies were properly conducted, even if this machinery might be slightly unfair to individuals. The court refused to review the Minister's decision on the grounds that, by refusing to state his reasons, the Minister must be assumed to have no good reasons. So long as the Minister acted in good faith, he need not disclose his reasons.

The duty of inspectors to act fairly should not be elaborated so as to turn a basically inquisitorial procedure into an accusational procedure.

59 *Government of India* v *Sahu Jain Ltd*, [1969] 1 Comp LJ 231.

60 *Deputy Secy, Ministry of Finance* v *Sahu Jain Ltd*, (1970) 40 Comp Cas 83 Cal.

61 *Punjab Agro Industries Corpn Ltd* v *Superior Genetics (India) Ltd*, (2002) 108 Comp Cas 349 CLB.

62 *Sahu Jain Ltd* v *Deputy Secy, Ministry of Finance*, [1965] 2 Comp LJ 145. S. 238 provides that no firm, body corporate or other association shall be appointed as an inspector under Ss. 235 and 237.

(*b*) otherwise to give to the inspector all assistance in connection with the investigation which they are reasonably able to give."

For facilitating the task of the inspector, it is the duty of all officers in charge of the management of the company to produce to the inspector all books and papers of the company which are in their custody and power and to give to the inspector all assistance in connection with the investigation which they are reasonably able to give.[63] The inspector may examine on oath any such person and for this purpose require his personal attendance.[64] If a person required to appear or produce books, makes a default, that is a punishable offence.[65] Where an inspector finds that a person, whom he has no power to examine on oath, ought to be so examined the inspector may do so with the previous approval of the Central Government. Notes of any such examination are to be taken in writing and signed by the person examined and may be used in evidence against him.[66] A refusal to answer questions is also punishable. For example, in *Pergamon Press Ltd, Re*,[67] the company was engaged in a litigation in a foreign country. Its officers felt that any information given by them might pass to the foreign party and adversely affect their case. So they refused to give any information unless an assurance was given to them that it would not be published without being shown to them. Even so they were held guilty of contempt.

In an English case,[68] an Inspector of Companies was not allowed to be questioned or cross-examined as to why he caused an examination of the company's books and what he considered to be the public interest that made it expedient that the company be wound up. The power is of subjective nature and its exercise could only be challenged on an allegation of bad faith or if the inspector could be shown to have taken into account extraneous material or had otherwise misdirected himself as to the nature of his power,[69] or has been shown

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63 S. 240. This duty is imposed upon all officers and other employees and agents of the company, and where the company is or was managed by a managing agent, or secretaries and treasurers, upon all officers and agents of any such concern, or, where the affairs of any other company, managing agent, or secretaries, treasurers are investigated under S. 239, upon all officers and agents of such company, etc., or where it is a firm, upon all its partners.

64 S. 240(2).

65 S. 240(3).

66 S. 40(5). See *R* v *Harris (Richard)*, [1970] 1 WLR 1252: [1970] 3 All ER 746 (CCA). evidence admitted in criminal proceedings.

67 [1970] 3 WLR 792: [1970] 3 All ER 535 CA. *See* also *Armuent, Re*, [1975] 3 All ER 441, where it was held that the report of inspectors was *prima facie* evidence admissible for founding a winding up order. *See* further *An Inquiry under the Company Securities (Insider Dealings) Act, 1985, Re*, 1988 BCLC 153 HL: [1988] 1 All ER 203, where the House of Lords consider the privilege of a financial journalist not to disclose his sources of information about a take-over: *Lonrho plc* v *Secy of State for Trade and Industry*, [1989] 2 All ER 609, where refusal to publish the report was considered by the House of Lords as justified because publication would have prejudiced further proceedings in the matter. *London United Investments plc, Re*, [1992] 2 All ER 842 CA, the privilege against self-incrimination is not available in answering questions on which the inspector is seeking information. Also on the same point, *Bishopgate Investment Management Ltd* v *Maxwell*, [1992] 2 All ER 856 CA.

68 *Golden Chemical Products Ltd, Re*, The Times, December 10, 1976: 1976 JBL 55.

69 *See* further *London & County Securities Ltd* v *Nicholson*, [1980] 1 WLR 948, question of privilege.

to be making an unfair exercise of his power. The principle of bias does not apply to an investigation where the officers are exercising a policing function. The court's powers of review are, however, not limited to cases where it could be shown that the officers had not acted *bona fide*. The ground of unfairness does apply.[70]

In reference to the report, it has been held in some English cases that it "being a statutory report made by persons in a statutory fact-finding capacity, the court must be entitled to look at it and act upon it, unless it is challenged on behalf of the company."[71]

In still another English case,[72] in the course of his report, the inspector found that the sum of approximately £44,000 had been taken away from the resources of the company. The report also noted the manner of misappropriation and the officers involved. Relying upon an earlier decision[73] the court held that the function of the inspector is to make an inquiry and report and not to come to a judicial decision and, therefore, it is not a proceeding of such a nature that prohibition can lie in respect of it either to the Board of Trade or to the inspector.

Where the report of an inspector was highly critical of the conduct of the chairman and chief executive of the company and the latter challenged its fairness on the ground that the inspector had violated rules of natural justice by not giving him a chance of explaining matters before signing his report, the court allowed him no relief.[74] The court pointed out that the report of the inspector is not an evidence in the real sense of the word and, therefore, the persons hit by the report have every chance to disprove its contents. But without doing so they cannot ask the court not to act on it.

Seizure of books [S. 240-A]

Where the inspector has reasonable grounds to believe that relevant books or papers may be destroyed or falsified, he may make an application to a Magistrate and obtain an order for the seizure of such books and papers. The order may authorise him to enter the place where such books and papers are kept, to search the place and to seize them. At the conclusion of the investigation the inspector must return the documents.

Report [S. 241]

The inspector has to prepare and submit a report to the Central Government. The Government is bound to forward a copy of the report to the company at its registered office and also to any company, managing agent, secretaries or

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70 *R* v *Secy of State for Trade, ex p Perestello*, (1979) 124 SJ 63.

71 *Travel and Holiday Clubs Ltd, Re*, [1970] 1 WLR 711: [1967] 2 All ER 606. The report is an evidence only for the purposes of being used as a material for winding up or proceedings against persons commented upon. *Savings and Investment Bank Ltd* v *Gas Co*, [1984] 1 All ER 296 Ch D.

72 *SBA Properties Ltd, Re*, (1967) 1 WLR 799: [1967] 2 All ER 615.

73 *Grosvenor and West End Railway Terminus Hotel Co. Re*, [1897] 76 LT 337: [1895-9] All ER Rep Ext 1836.

74 *Maxwell* v *Department of Trade*, [1974] 2 All ER 122 CA.

treasurers or associates dealt with in the report by virtue of Section 239. Where the inspector was appointed on the application of the members, a copy has to be sent to them also if they request for it and where he was appointed on the court's order, a copy must be sent to the court also. Where an inspector is appointed at the instance of the Tribunal, a copy of the report should be sent to it. Other interested persons may obtain the report on payment of prescribed fee and the Government may also cause the report to be published.

If the report shows that any person has committed any offence for which he is criminally liable, the Government may prosecute him for the offence. Further, the Government may, on the basis of the report, apply to the court for the winding up of the company or make an application for an order under Sections 397 and 398 for prevention of oppression and mismanagement.

Where it appears from the report that a fraud or misappropriation of property has been committed and the company is, therefore, entitled to bring an action for damages for the misconduct or for the recovery of any property which has been misapplied or wrongfully retained, the Central Government may itself bring proceedings for that purpose in the name of the company. In any such proceeding the report shall be admissible as evidence of the opinion of the inspector in relation to any matter contained in the report.[75]

The expenses of investigation are to be defrayed in the first instance by the Central Government. But the Government is entitled to be reimbursed by any person who has been convicted on a prosecution instituted in pursuance of the report or required to pay damages as a result of the report. The company in whose name proceedings are brought is also bound to reimburse the Government. Reimbursements can also be recovered from any managerial personnel dealt with by the report and from the applicants.[76]

Investigation of ownership of company [S. 247]

Public interest may sometimes require the Central Government to know the persons who are financially interested in a company and who control its policy or materially influence it. For this reason, Section 247 provides that where there is good reason to do so, the Government may appoint one or more inspectors to investigate and report on the membership of the company and other matters relating to it. The amendment of 1988 empowers the Tribunal, while dealing with any proceedings before it, to declare by an order that the affairs of the company ought to be investigated as regards the ownership for the purpose of determining as to who are or have been financially interested in the success or failure, whether real or apparent of the company or able to control or materially influence the policy of the company. In such a case, the Government becomes bound to appoint inspectors. Subject to the restrictions imposed by the Government, the inspector shall have the power to investigate any circumstances which

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75 S. 246. The report has to be filed in proceedings initiated on its basis, but otherwise it is a privileged document. The court may order its production in a proceeding for production of privileged documents. *Saden* v *Burns*, (1996) 2 BCLC 636 Ch D; *R* v *Secretary of State for Trade and Industry*, (1996) 2 BCLC 636 Ch D.

76 S. 245.

suggest that there is some arrangement or understanding which, though not legally binding has been or is likely to be observed by the company in practice.[77] If the company is or was being managed by a managing agent, secretaries and treasurers, the powers of the inspector will extend to investigate the ownership and control of shares, where such managing agent or secretaries and treasurers is a company, and where it is a firm, the inspector shall have the power to find out the persons who manage or control its affairs as partners. Further, he shall also have the power to know the persons who share or shared the remuneration of such managing agent or secretaries and treasurers.[78]

An inspector appointed for this purpose shall have the same powers with regard to production and seizure of documents and evidence as are enjoyed by an inspector appointed for investigation under Section 235.[79]

After the conclusion of the investigation, the inspector submits a report to the Central Government. The Government, however, in this case is not bound to furnish a copy of the report to the company or any other person, if it is of opinion that there is good reason for not divulging the contents of the report. But the Central Government shall have to keep with the Registrar a copy of such parts of the report as need not be that confidential.[80]

The expenses of this investigation are to be defrayed by Government out of money provided by Parliament. But the Government may order recovery of the expenses from persons on whose application the investigation was ordered.[81]

Investigation of ownership of shares [S. 248]

This section was omitted by the Amendment Act of 2000.[82]

Restrictions upon shares and debentures [S. 250]

If as a result of any one of the above types of investigations or otherwise, it appears to the Tribunal that there is good reason to find out full facts about any shares in a company, the Tribunal may, if it is necessary for the purpose, impose the following restrictions on the shares:

(*a*) Any transfer of those shares shall be void.

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77 S. 247(3).

78 S. 247(4).

79 S. 247(5).

80 S. 247(5), proviso.

81 S. 247(6).

82 Where persons in management were also holding controlling interest in the company, their attempt to have the ownership of an insignificant percentage of shares investigated did not succeed. *Bakhtawar Construction Co (P) Ltd* v *Blossom Breweries Ltd*, (1997) 88 Comp Cas 859 (CLB-PB). Cancellation of shares allotted to a managing director on his ceasing to be so and allotting them to another person by creating duplicates was held to be a matter not requiring investigation, *Abani Bhushan Bhattacharya* v *Ericson India (P) Ltd*, [1997] 4 Comp LJ 473 CLB. Statement of facts appearing in management report showing irregularities, held not sufficient to invite investigation, *A P State Civil Supply Corpn Ltd* v *Delta Oils & Fats Ltd*, [1997] 3 Comp LJ 146 (CLB-PB). Where it is necessary to do so, an order of investigation can be made at the instance of even a small shareholder. *Padma Taparia* v *Assambrook Ltd*, (1997) 88 Comp Cas 838 CLB. An investigation under the section can be ordered only in a proceeding pending before the CLB. *Bakhtawar Construction Co (P) Ltd* v *Blossom Breweries Ltd*, (1998) 91 Comp Cas 744 CLB.

(*b*) Where those shares are to be issued, they shall not be issued and any issue shall be void.

(*c*) No voting right shall be exercisable in respect of those shares.

(*d*) No further shares shall be issued in the right of those shares.

(*e*) Except in a liquidation, no payment shall be made of any sums due from the company on those shares whether in respect of dividend, capital or otherwise.[83]

These restrictions may be imposed for any period, but not exceeding three years.

Another power of the Tribunal under this section is that where as a result of any transfer of shares a change is likely to take place in the composition of the company's Board of directors, and if such change would be prejudicial to the public interest, the Tribunal may restrain such change from taking place unless the change is confirmed by it and may direct that voting rights on those shares shall not be exercisable for any period not exceeding three years.[84]

Where any transfer of shares involving any of the above changes is likely to take place, the Tribunal may restrain the transfer for any period not exceeding three years.[85] A restriction of this kind is likely to have a telling effect upon the image of the company and prejudicing the interests of many individual and institutional investors who may not be a party to anything wrong. This fact has to be kept in mind by the Tribunal before passing any restraint order. For example, no such order was passed in an English case in which an investor being called upon to give information about the nature of his interest in the company's shares, gave wrong information, but soon thereafter acknowledged and rectified his errors and also gave an undertaking that he would not dispose of his interest in the shares unless permitted.[86] A restraint order was held to be justified where the nominee shareholders did not attach any importance and gave no response to a notice under the section.[87] In another case arising in connection with the same group of companies,[88] HARMAN J explained the matter in these words:

> Although a company has a *prima facie* right to know who owns its shares, the Act makes it a matter for the discretion of the court [in India the

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83 S. 250(2).

84 S. 250(3). Where transfer of shares and changes in the composition of the board of directors had already taken place and that too with the approval of the Company Law Board, the preventive powers under the section were not exercisable. *Alakananda Mfg and Finance Co (P) Ltd* v *Bahubali Services Ltd*, [1993] 3 Comp LJ CLB New Delhi. An investment in the shares of a company to the extent of only 10% of the share capital of the company has been held to be not so substantial as can make prejudicial changes in the management and require an order of investigation for imposing restrictions on shares. *Padma Taparia* v *Assambroke Ltd*, (1997) 88 Comp Cas 838 CLB.

85 S. 250(4). *Bakhtawar Construction Co (P) Ltd* v *Blossom Breweries Ltd*, (1999) 95 Comp Cas 35 CLB, promoters restrained from transferring shares out of their promoters' quota till the final disposal of the petition.

86 *Lonrho plc (No 3), Re*, 1989 BCLC 480 Ch D. A similar case is, *Ricardo Group plc, Re*, 1989 BCLC 566 Ch D where the restraint order was vacated as soon as the correct information was provided.

87 *Ricardo Group plc (No 2), Re*, 1989 BCLC 771 Ch D.

88 *Ricardo Group plc (No 3), Re*, 1989 BCLC 771 Ch D.

Tribunal] whether or not a freezing order under the section should be imposed or continued. On the facts, the failure to release shares from the freezing order could have the effect of preventing a take-over bid from going ahead and this could prejudice those shareholders who wanted to accept the bid.

The Tribunal will refuse an order or vacate it, where it was sought not in the interests of the company but to enable the directors to defend their position.

As long as the order is in force, any pending transactions can be finalised only with the leave of the Tribunal.[89]

Section 250-A provides that an investigation may be initiated even when an application for prevention of oppression or mismanagement is pending or the company has passed a special resolution for voluntary winding up. Similarly, an investigation which is in progress will not be stopped or suspended by reason of the fact that an application for prevention of oppression or mismanagement has been made or a special resolution for winding up has been passed.[90]

A Central Government can use the power under this section to make a reference only in connection with an investigation under Sections 247, 248 or 249. Hence, for the purpose of entertaining a petition under S. 250 the grounds specified in any of the above sections must be satisfied. Section 250(1) is only facilitative in nature. It facilitates investigations under the abovementioned sections.[91]

Position of legal advisers and bankers

On this point Section 251 provides as follows:

S. 251. Saving For Legal Advisers and Bankers.—Nothing in Sections 234 to 247 and Section 250 shall require the disclosure to the Registrar or to the Central Government or Tribunal or to an inspector appointed by the Government—

(*a*) by a legal adviser, of any privileged communication made to him in that capacity, except as respects, the name and address of his client; or

(*b*) by the bankers of any company, body corporate, [* * *] or other person, referred to in the sections aforesaid, as such bankers, of any information as to the affairs of any of their customers other than such company, body corporate, [* * *] or person.

COMPANY LAW BOARD [S. 10-E]

Abolition of Company Law Board

As and when the Companies (Second Amendment) Act, 2002 is enforced the Company Law Board would cease to exist. Its powers and functions would become vested in the National Company Law Tribunal (Tribunal) and appeals

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89 *Geers Gross plc, Re*, 1988 BCLC 140 CA; [1988] 1 All ER 224 CA; *T. R. Technology Investment Trust, Re*, 1988 BCLC 256 Ch D.

90 Employees are protected by S. 635-B by providing that Government must be informed of any action against an employee. *Ashoka Marketing Co* v *Addl Registrar of Companies*, (1985) 57 Comp Cas 117 Cal.

91 *Bakhtawar Construction Co P Ltd* v *Blossom Breweries Ltd*, (1997) 88 Comp Cas 859 (CLB-PB); (1998) 91 Comp Cas 744 CLB.

from its decisions will be heard by the Appellate Tribunal and a further appeal would lie before the Supreme Court.

The statement on the Company Law Board has been retained because the principles enshrined in the statement are likely to be followed in all company adjudications.

Constitution and powers [S. 10-E]

Establishment of the Board of Company Law Administration is one of the important effects of the Amendment Act of 1963. Section 10-E authorised the Central Government to constitute the Board. The amendment of 1988 renewed the power of the Central Government and also effected certain other changes in the section.[92] The function of the Board is to exercise the powers and discharge the functions as may be conferred on it under the Act or under any other law and has also to exercise and discharge such other powers and functions of the Central Government under the Act or any other law as may be conferred on it by the Central Government.

The Board is to consist of such number of members, not exceeding nine, as the Central Government deems fit. One of the members is appointed by the Government as the chairman of the Board. The Board may delegate any of its powers to the chairman or any member or its principal officer.[93] This power was conferred on the Board by S. 10-E (4-A) introduced by the Amendment Act of 1965, and as further amended in 1988.

The members of the Board shall possess such qualifications and experience as may be prescribed.[94] Acts done by the Board cannot be called in question only on the grounds of any defect in the constitution of the Board.

The composition of the Board was increased from five to nine members. This became necessary to enable the Board to deal with the new business which is being transferred to it under the Amendment Acts. The power of the court under Section 17 to confirm alterations in memoranda, to sanction under Section 73 issue of shares at a discount, to call a general meeting under Section 186, to order rectification of the register of charges, to order rectification of register of members under Section 111 and to provide relief against oppression and mismanagement under Sections 397-409 have been transferred to the Board. The Board is also to share the power of the Central Government under Section 637-A to grant approvals, etc.

Three new sub-sections have been added to Section 10-E to facilitate the handling of the new business. Sub-section (4-B) empowers the Board, to form one or more benches to exercise special functions. Any act of a Bench shall be deemed to be an act of the Board.

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92 The amendment has been enforced w.e.f. 4-8-1989, GSR 139 (E) of 4-8-1989.

93 S. 10-E(6). See *Alak Prakash Jain* v *UOI*, (1973) 43 Comp Cas 68, 99-100 Cal.

94 Qualifications have been prescribed under CLB (Qualifications, Experience and other Conditions of Service of Members) Rules 1993 (w.e.f. 28-4-1993) and the same have been found to be constitutionally valid. *Satish Chandra* v *UOI*, (1994) 5 SCC 495: (1994) 81 Comp Cas 482 SC: AIR 1995 SC 142. The matters relating to disqualifications of members is under the jurisdiction of the Central Administrative Tribunal, *A K Doshi (Dr)* v *Central Administrative Tribunal*, [2000] CLC 1428 Delhi.

Most of the powers transferred to the Board being of judicial nature, sub-section (4-C) provides that every bench shall have the powers of the court under the Civil Procedure Code, 1908, in respect of the following matters:

1. discovery and inspection of documents or other material objects produced as evidence;
2. enforcing the attendance of witnesses and requiring the deposit of their expenses;
3. compelling the production of documents or other material objects producible as evidence and impounding the same;
4. examining witnesses on oath;
5. granting adjournments;
6. reception of evidence on affidavits.

Sub-section (4-D) further declares that every bench shall be deemed to be a civil court (for the purpose of Section 195 of Chapter 35 of the Criminal Procedure Code) and every proceeding before it shall be a judicial proceeding. This will enable the Board to punish any person for its contempt.

By the amendment of 1977 the Board has been given the power of an execution court; Section 634-A has been added for the purpose. The section authorises the Board to execute or enforce its orders in the same manner as if it were a decree issued by a court; where the Board is not able to execute an order, it may send the order to the court within whose jurisdiction the company's office falls or the individual against whom the order is issued resides or works.

The amendment of 1988 declares that the Company Law Board shall, in the exercise of its powers and discharge of its functions under the Act or under any other law, be guided by the principles of natural justice and shall act in its discretion. The amendment also provides that subject to the provisions of the section, the Board shall have the power to regulate its own procedure.[95]

The CLB has to act in accordance with the principles of natural justice and also its own Regulations. The provisions of the Indian Evidence Act, 1872 and those of the Code of Civil Procedure do not apply to the proceedings before the Board.[96]

The Company Law Board does not have the power to review its own decisions under the existing provisions of the Companies Act.[97] An appeal was

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95 CLB Regulations, 1991. The constitutional validity of Ss. 10-E and 10-F was upheld by the Madras High Court in *V. Balachandran* v *UOI*, (1993) 76 Comp Cas 67 Mad. The right of appeal against the decisions of the Board as also under writ jurisdiction are sufficient checks upon the powers of the Board. *Shri Ramdas Motor Transport Ltd* v *Karedla Suryanarayana*, (2002) 110 Comp Cas 193 AP, the procedure must satisfy the requirements of natural justice.

96 *Rajinder Kumar Malhotra* v *Harbans Lal Malhotra & Sons Ltd*, (1996) 87 Comp Cas 146 CLB.

97 *Paulose (MV)* v *City Hospital P Ltd*, (1998) 28 Corpt LA 46 CLB. In exceptional cases, it may use its inherent powers, for example, in this case, restoring a petition which was dismissed earlier under mistake of facts, or of law. *Shree Cement Ltd* v *Power Grid Corpn Ltd*, (1999) 93 Comp Cas 854. The Supreme Court observed in *United India Insurance* v *Rajendra Singh*, (2000) 37 CLA 405 at 409 that the remedy to move for recalling an order on the basis of newly discovered facts which showed fraud cannot be foreclosed. No court or tribunal can be regarded as powerless to recall its own order if the order was wangled through fraud or misrepresentation.

held to be maintainable to challenge the jurisdiction of the Company Law Board to pass consent orders.[1]

Where an Act, constituting special courts for trying cases arising out of securities scam relating to transfer of securities, excluded the jurisdiction of all other courts, it was held that the jurisdiction of the Company Law Board was not thereby affected because it is neither a court nor a civil court.[2] This decision of the Company Law Board was reversed on appeal to the High Court of Delhi. The High Court was of the view that the very purpose of the special courts is such that the jurisdiction of all courts and tribunals over the same subject-matter is necessarily excluded.[3]

Appeals against orders of CLB [S. 10-F]

The amendment of 1988 introduced a new section to provide about appeals. Since the Board has been taken out of the controlling hand of the State and has been made independent and its powers and functions have been enlarged by conferring upon it jurisdiction in many company matters which was being exercised by the High Courts, an express provision as to appeals became necessary. Section 10-F provides that any person aggrieved by any decision or order of the Company Law Board may file an appeal to the High Court on any question of law arising out of such order.[4] Thus there can be no appeal on a question of fact. The Board has become the final authority so far as questions of fact are concerned. Since facts are discovered by appreciation of evidence and if the appreciation has gone wrong, factual matters can also be reopened in appeal.[5] A finding of fact which is based on no evidence or based on surmises, conjectures or assumptions, amounts to a finding without evidence. It becomes a question of law, and as such appealable.[6]

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1 *Prakash Timbers P Ltd* v *Sushma Singla*, AIR 1995 All 320.

2 *Canara Bank* v *Nuclear Power Corpn of India*, (1995) 84 Comp Cas 62 CLB, Special Court (Trial of Offences relating to Transactions in Securities) Act, 1992. The Company Law Board is not a court for all purposes. *Prakash Timbers (P) Ltd* v *Sushma Singla*, AIR 1996 All 262: (1997) 89 Comp Cas 770. The court picked up passages as to the trappings of a court from *Shell Company of Australia* v *Federal Commissioner of Taxation*, 1931 AC 275.

3 *ABN Amro Bank* v *Indian Rly Finance Corpn Ltd*, (1996) 85 Comp Cases 716 Del.

4 *Mohd Zafar* v *Nahar Industrial Enterprises Ltd*, (1998) 28 Corpt LA 251: (1998) 93 Comp Cas 717: [1997] 4 Comp LJ 201 Delhi, where a question of law was neither raised before the CLB nor taken up by the CLB, it could not be said to be question arising out of CLB order. Another decision of the same kind *Gordan Woodroffs & Co Ltd UK* v *Gordan Woodroffe Ltd*, (1999) 97 Comp Cas 582, where the court also added that it is a limited jurisdiction and, therefore, the appellate court cannot go into the validity of a transfer which requires consideration of evidence including examination of witnesses.

5 A finding of fact based upon proven facts is not a question of law. A finding that the requirement of S. 84 for issuing duplicate share certificates was not satisfied was held to be a finding of fact, *Shoe Specialities Ltd* v *Tracstar Investments Ltd*, (1997) 88 Comp Cas 471 Mad. Maintainability of a petition is not a pure question of law, it being mixed up with facts involved, a decision on maintainability was held to be not appealable, *Saroj Goenka* v *Nariman Point Building Services and Trading P Ltd*, (1997) 90 Comp Cas 205 Mad. The question whether the notice of a meeting was late was not raised before the Company Law Board and, therefore, not decided by it, could not be the subject-matter of appeal, *Mohd Jafar* v *Nahar Industrial Enterprises Ltd*, [1997] 4 Comp LJ 201 Delhi.

6 *Scientific Instruments Co Ltd* v *R. P. Gupta*, (1999) 34 CLA 36 All.

In the exercise of its inherent powers, the CLB can take notice of subsequent events lest it may fail to do justice between the parties.[7]

The phrase "arising out of" in Section 10-F would include questions of law arising out of facts found by the CLB.[8] An order as to joinder of parties is a question of law and, therefore, appealable.[9] Consent orders are appealable.[10] A dispute as to shareholding pattern was resolved by the Company Law Board under a consent order. There was no grievance as to the genuineness of the consent. The court did not interfere with the order in appeal.[11]

Where in a petition for prevention of oppression and mismanagement, the finding of fact by the CLB was that the preliminary requirements were not satisfied, the Court refused to interfere as it found that the finding was based on the evidence on record. The court said that the section does not permit investigation into a question of fact even where additional evidence is tendered to question the finding of fact.[12] There can be no appeal on a finding of fact even if the appellate court might have differed.[13] The words "any decision or order" would include an order which does finally decide the rights of the parties. In a petition by a director who was taken to have vacated his office by reason of non-attendance, the new appointee in his place was not impleaded and without any information to him an order was passed for the management of the company by the first directors. This order was held to be appealable. The order was set aside because it violated natural justice.[14]

An order passed on consent terms was held to be not appealable.[15]

The time for filing appeals has been fixed to be 60 days which are to be counted from the date of the communication of an order or decision to the appellant. The High Court has been empowered on sufficient cause to extend the time for a further period of 60 days.

The provisions of the Civil Procedure Code have to be followed to the extent applicable. Accordingly, the memorandum of appeal should be accompanied by a certified copy of the order appealed against or at least of the operative portion of the order.[16]

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7 *Rajendra Kumar Malhotra* v *Harbans Lal Mehrotra & Sons Ltd*, (1999) 34 CLA 360 Cal.

8 *Nupur Mitra* v *Basubani P Ltd*, (1999) 35 CLA 97 Cal.

9 *Gillette International* v *R K Malhotra*, (1998) 31 CLA 73 Cal.

10 *Prakash Timbers P Ltd* v *Sushma Singla*, AIR 1995 All 320.

11 *Subhash Mohan Dev* v *Santosh Mohan Dev*, [2000] CLC 1151 Gau.

12 *J P Srivastava & Sons (Rampur) P Ltd* v *Gwalior Sugar Co Ltd*, [2000] CLC 1792 MP.

13 *Chand Mall Pincha* v *Hathi Mall Pincha*, (1999) 95 Comp Cas 368 Gau. See also *Boiron* v *SBLP Ltd*, (1999) 33 CLA 51 Delhi, where the finding of fact was that a ground for an order of investigation was made out, the court refused to interfere. *T G Veera Prasad* v *Sree Rayalaseema Alkaline & Allied Products Ltd*, (1999) 98 Comp Cas 806 AP. No appeal was allowed against an order for appointment of an administrator, *C Sri Hari Rao* v *Sri Ram Das Motor Transport (P) Ltd*, (1999) 97 Comp Cas 685.

14 *Gharib Ram Sharma* v *Daulat Ram Kashyap*, (1994) 80 Comp Cas 267 Raj.

15 *Subhash Mohan Dev* v *Santosh Mohan Dev*, (2001) 104 Comp Cas 405 Gau.

16 *Manohar Rajaram Chhabaria* v *Union of India*, (2002) 110 Comp Cas 162 Cal.

An appeal would lie before the High Court where the registered office of the company is situate and not at the place where a decision of the Company Law Board or any of its Benches was delivered.[17]

National Company Law Tribunal

Constitution and Powers [S. 10-FB]

One of the important effects of the Companies (Second Amendment) Act, 2002 is the establishment of the National Company Law Tribunal in place of the Company Law Board. Section 10-FB provides that the Central Government will by notification in the Official Gazette, constitute a tribunal to be known as National Company Law Tribunal. The function of the tribunal is to exercise the powers and discharge the functions as may be conferred on it under the Act or under any other law for the time being in force.

The Tribunal is to consist of such a number of judicial and technical members, not exceeding sixty-two as the Central Government deems fit. A person who has been, or is qualified to be a Judge of a High Court will be appointed as President by the Central Government.

The members of the tribunal, both judicial and technical, shall possess such qualifications and experience as may be prescribed. Any judicial or technical member will be appointed by the Central Government as member administration who shall exercise such financial and administrative powers as may be vested in him under the rules which may be made by the Central Government. Such member administration will have authority to delegate such of his financial and administrative powers as he may think fit to any other officer of the tribunal who will act under the direction, superintendence and control of the member administration.

The powers of the Tribunal may be exercised by the Benches, constituted by the President of the Tribunal. One shall be a Judicial Member and another shall be a Technical Member. There may be a single member Bench, two-member Bench and in case of rehabilitation, restructuring or winding up of companies special Benches consisting of three or more members may be constituted by the President of the Tribunal (Section 10-FL). There shall be a Principal Bench at New Delhi presided over by the President of the Tribunal in addition to other Benches. The Principal Bench of the Tribunal will have the power of transfer of proceedings from any Bench to another Bench in the event of inability of any Bench from hearing any such proceedings after recording reasons for transfer in writing. If the members of a Bench differ in opinion, the matter will be decided by the majority, if there is a majority but in case the members are equally divided, then such points of difference will be noted and the case will be referred to the President of the Tribunal.

The Tribunal may pass such order as it thinks fit after giving the parties an opportunity of being heard. The Tribunal may also amend its order within 2

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17 *Stridewell Leathers (P) Ltd* v *Bhankerpur Simbhaoli Beverages P Ltd*, (1994) 1 SCC 34: (1994) 79 Comp Cas 139 SC, reversing Delhi High Court in *Bhankerpur Simbhadi Beverages (P) Ltd* v *CLB*, (1994) 1 SCC 34: (1994) 79 Comp Cas 139 SC.

years of passing it if there is any mistake apparent from the record which is brought to its notice by the parties [S. 10-FM]. The Tribunal may also review its own orders [S. 10-FN]. The Tribunal may delegate such powers and duties under this Act as it deems necessary to any member or officer or other employee of the Tribunal or other person authorised by the Tribunal to manage any industrial company, industrial undertaking or operating agency. The delegation may be by special or general order and with specified conditions and limitations [S. 10-FO].

The Tribunal has also been given the power to seek assistance of Chief Metropolitan Magistrate and District Magistrate under S. 10-FP. If the Tribunal or any operating agency wants to take into possession any property, books of account or other documents of a sick industrial company. It may for this purpose, make a request in writing to the Chief Metropolitan Magistrate or District Magistrate within whose jurisdiction such things are situated or found. On such request the Chief Metropolitan Magistrate or District Magistrate may take possession of the property, books of account or any other document by taking necessary steps and using necessary force. No act of Chief Metropolitan Magistrate or District Magistrate taken under this section shall be called in question in any court or before any authority on any ground whatsoever [S. 10-FP].

Appeals against orders of National Company Law Tribunal [S. 10-FQ]

Appeals against orders or decisions of the Tribunal will lie before an Appellate Tribunal known as National Company Law Appellate Tribunal constituted under Section 10-FQ. [*Vide*, Companies (Second Amendment) Act, 2002]. However, where the order or decision is made by the Tribunal with the consent of the parties, no appeal will lie against it. The appeal may be filed within a period of forty-five days from the date of receiving the order or decision by the appellant. The appeal has to be in the prescribed form and accompanied by prescribed fee. However, if sufficient cause for delay is given, the Appellate Tribunal may extend the time for filing the appeal. The Appellate Tribunal after giving an opportunity of being heard to the parties may confirm, modify or set aside the order appealed against. The time-limit for disposing of the appeal finally is six months.

The Appellate Tribunal will consists of a Chairperson and not more than two members, all of them will be appointed by the Central Government. The chairperson shall be a person who has been a Judge of the Supreme Court or the Chief Justice of a High Court. A member of the Appellate Tribunal shall be a person of ability, integrity and standing having special knowledge and professional experience of not less than 25 years in science, technology, economics, banking, industry, law, matters relating to labour, industrial finance, industrial management, industrial reconstruction, administration, investment, accountancy, marketing or any other matter, the special knowledge or professional experience of which would be useful to the Appellate Tribunal in the opinion of the Central Government.

The Tribunal and Appellate Tribunal shall not be bound by the procedure laid down in Code of Civil Procedure, 1908 but shall be guided by the principles of natural justice and subject to other provisions of this Act and of any rules made by the Central Government. The Tribunal and the Appellate Tribunal shall have the power to regulate their own procedure. [S. 10-FZA].

While trying a suit, the Tribunal and the Appellate Tribunal shall have the same powers as are vested in a civil court under the Civil Procedure Code, 1908, in respect of the following matters:

(*a*) summoning and enforcing the attendance of any person and examining him on oath;

(*b*) requiring the discovery and production of documents;

(*c*) receiving evidence on affidavits;

(*d*) requisitioning any public record or document or their copies from any office subject to the provisions of Ss. 123 and 124, Indian Evidence Act, 1872;

(*e*) issuing commissions for examination of witnesses or documents;

(*f*) reviewing its decisions;

(*g*) dismissing a representation for default or deciding it ex parte;

(*h*) setting aside any order of dismissal of any representation for default or any order passed by it ex parte; and

(*i*) any other matter which may be prescribed by the Central Government.

The Tribunal or the Appellate Tribunal has been given the power of an execution court. Section 10-FZA authorises the Tribunal or Appellate Tribunal to execute or enforce its orders in the same manner as if it were a decree issued by a court; but where the Tribunal or the Appellate Tribunal is not able to execute an order, it may send the order to the court within whose jurisdiction the company's office falls or the individual against whom the order is issued resides or works.

The Tribunal and the Appellate Tribunal shall be deemed to be civil courts (for the purposes of S. 195 and Chapter XXVI of the Criminal Procedure Code, 1973) and every proceeding before them shall be deemed to be a judicial proceeding. The Appellate Tribunal has also the power to punish any person for its contempt.

No civil court shall have jurisdiction to entertain any suit or proceeding in respect of any matter which the Tribunal or the Appellate Tribunal is empowered to determine. [S. 10-GB].

The applicant or the appellant may either appear in person or authorise one or more chartered accountants or company secretaries or cost accountants or legal practitioners or any officer to present his or its case before the Tribunal or the Appellate Tribunal, as the case may be. [S. 10-GD].

The provisions of the Limitation Act, 1963 are applicable to an appeal before the Appellate Tribunal. [S. 10-GE].

An appeal against any decision or order of the Appellate Tribunal will lie in the Supreme Court. The appeal must be filed within 60 days from the date of

communication of the dicision or order. But where the Supreme Court is satisfied that there was sufficient ground for not filing the appeal within 60 days, it may extend the period for filing the appeal up to next 60 days only. [S. 10-GF].

Advisory Committee [S. 410]

The Companies (Amendment) Act, 1965, abolished the Advisory Commission. Instead, we now have an Advisory Committee. The Amendment says that "in the heading of Chapter VII" of Part VI for the words "Advisory Commission", the words "Advisory Committee", shall be *substituted.* All the sections of this Chapter were repealed and only one section remained, namely, Section 410. This section reads: "For the purpose of advising the Central Government and the Tribunal on such matters arising out of the administration of this Act as may be referred to it by that Government or Tribunal, the Central Government may constitute an Advisory Committee consisting of not more than five persons with suitable qualifications." Thus the Advisory Committee has the dual function of advising the Central Government and the Tribunal on the matters referred to it for advice.

The Advisory Committee differs in important respects from its predecessor, the Advisory Commission. The function of the Advisory Committee is to advise the Government and this was also the function of the Commission. But the Commission had the duty and power to inquire into matters enumerated in the now repealed Section 411. Further the Commission had, under Section 413 (now repealed) the powers of a court for the production of evidence and witnesses whenever necessary for the purpose of an inquiry. Such powers have not been conferred on the Advisory Committee.

Company Courts [S. 10]

Section 10 indicates the jurisdiction of company courts. The section says that the court having jurisdiction under the Act means the High Court of the area in which the registered office of the company is situate, except to the extent to which jurisdiction has been conferred on any District Courts or District Courts subordinate to that High Court. Such District Court functions as a company court in respect of companies having their registered office in the District. The subject-matter of the jurisdiction shall be as may be conferred by the Central Government. Such jurisdiction cannot, however, be conferred in respect of matters specified in Sections 237 (investigation), 391, 394, 395 (reconstruction, compromise, arrangement, amalgamation, *etc.*), 397 to 407 (prevention of oppression and mismanagement). Such jurisdiction cannot also be conferred in respect of matters relating to winding up except in reference to companies with paid-up share capital of less than one lakh of rupees.

For the purposes of jurisdiction to wind up companies, the expression "registered office" of a company means a place which has longest been the registered office of a company during the six months immediately preceding the presentation of the petition for winding up. The jurisdiction to entertain a winding up petition is in the court in whose jurisdiction, the registered office of the company is situate. Such jurisdiction cannot be ousted or vested in any other

court by agreement, acquiescence or understanding. Participation in proceedings in a wrong court would not prevent the party from approaching the right court.[18]

Civil Courts

Jurisdiction in respect of the following matters has been conferred upon the District Courts:[19]

Termination of disproportionately excessive voting rights. (S. 89)

Issue of certificates. (S. 113) [Initial application to Central Government]

Right to inspect company's register of charges and copies of instruments creating charges. (S. 144) [Initial application to Central Government]

Place of keeping and inspection of registers and returns. (S. 163) [Initial application to Central Government]

Inspection of minutes-book of general meetings. (S. 196) [Initial application to Central Government]

Right of members to copies of balance-sheet and auditor's report. (S. 219) [Initial application to Central Government]

Power of Registrar to call for information or explanation. (S. 234)

Register of Directors, shareholdings. (S. 307) [Initial application to Central Government]

The Companies Amendment Act of 1988 had vested the jurisdiction under the above sections, excepting that under Section 234, in the Company Law Board. The 2nd Amendment of 2002 has vested these powers in the Central Government.

In matters other than those so handed over to the care of special jurisdictions, the ordinary civil courts have jurisdiction to provide remedies. In other words, the jurisdiction of ordinary civil courts is applicable except to the extent to which it has been excluded.[20]

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18 *Data Computer Services* v *Northern Digital Exchanges Ltd*, (1998) 92 Comp Cas 362 (P&H); *G T C Industries Ltd* v *Parasrampuria Trading & Finance P Ltd*, (1999) 34 CLA 350 All; *J G Finance Ltd* v *Jamna Auto Industries*, (1999) 34 CLA 382 (P&H).

19 Except those of Jammu and Kashmir and for the State of Orissa and the Union Territory of Himachal Pradesh, where the jurisdiction shall be as may be conferred by the High Court. GSR 663 of 19-5-1959.

20 See *Dhulabhai* v *State of M P*, AIR 1969 SC 78 and *Union of India* v *Tara Chand Gupta*, AIR 1971 SC 1558, as to exclusion of jurisdiction of ordinary civil courts. *Thiruvalu etc P Ltd* v *M. K. Seethai Achi*, [1987] 3 Comp LJ 129 Mad, action for accounts by managing director, matter for civil courts; *Prakasm* v *Sree Narayana Dharma Paripalna Yogam*, (1980) 50 Comp Cas 611 Ker, validity of a general meeting, not a matter for company courts; *M. G. Doshit* v *Reliance Petrochemicals*, (1994) 79 Comp Cas 830 Guj; breach of provisions at AGM, High Court had no jurisdiction. *Orissa State Financial Corpn* v *Kaliga Textile Ltd*, ILR 1973 Cal 38 Orissa, dispute about an underwriting agreement, a civil matter; *T. L. Arora* v *Ganga Ram Agarwal*, [1987] 1 Comp LJ 241 Delhi, election to directorship, a civil matter; *Maharaja Exports* v *Apparels Exports Promotion Council*, (1986) 60 Comp Cas 353, a general survey of case-law; *Niranjan Singh* v *Edward Ganj Public Welfare Assn Ltd*, (1977) 47 Comp Cas 285 P&H, election to directorship and validity of notice calling a meeting; *Ravinde Kumar Jain* v *Punjab Regd (Iron and Steel) Stocks Holders Assn*, (1978) 48 Comp Cas 401 P&H, questioning the validity of a meeting. *B. Sivaraman* v *Egmore Benefit Society Ltd*, (1992) 75

Where a company court ordered the transfer of shares but made it subject to the result in the pending proceeding under Ss. 397 and 398, it was held that the court could modify its orders from time to time finding that the order is affecting adversely one party or the other.[21]

Questioning the validity of meetings and of resolutions passed at meetings,[22] have been held to be matters for civil court jurisdiction.[23] A director who is affected by a disqualification provision can move the company court for adjudication on the operation of the provision.[24]

The effect of passing consent orders was examined by the Supreme Court in *Nazir Hoosein* v *Darayus Bhathena*[25]. The validity of the replacement of the chairman by means of a resolution was questioned in a suit. The appointment of 12 additional directors was also under question. A consent order was passed by the court for a new meeting under the chairmanship of the court nominated person for reconsideration of the whole agenda.

It was held that by virtue of the consent order what was resolved in the earlier meeting was wiped off and became non est. Consequently, without any fresh authority, the earlier Chairman could not preside over any meeting of the Board of directors as his authority was only through the earlier resolutions and as there was nothing to show that the Board of directors had elected him to function as Chairman in any meeting. When in accordance with the consent order, a meeting was held under chairmanship of *S* wherein it was resolved not to appoint 12 additional directors, then any resolution taking a contrary stand could not be sustained. Further, when in a subsequent meeting presided over by the earlier chairman a resolution was passed inducting 57 new life members, since this meeting was not conducted in proper perspective and it also suffered from procedural irregularities the business done was not valid. However, in order to protect the interest of the life members so inducted, their cases were directed to be placed before the next annual general meeting to be held for its consideration.

Comp Cas 198 Mad, questioning the validity of appointment as director and seeking his removal. *Patel Roadways Ltd* v *Prasad Trading Co*, (1991) 4 SCC 270: (1992) 74 Comp Cas 11 SC, action lies at the place according to the provisions of S. 20 CPC because the word "corporation" as used there includes company. *Kaushiklal Parikh* v *Mafatlal Industries Ltd*, (1995) 1 Corpt LA 102 Guj, questioning the validity of a resolution whether at board or company meeting in spite of the special provisions as to jurisdiction for petition against oppression and mismanagement because a resolution of the Board of directors can be attacked as invalid in a suit though it might not be oppressive to the minority shareholders or prejudicial to the company, while a resolution which may be valid in law might yet be oppressive to the minority shareholders. Following *Sheth Mohan Lal Ganpatram* v *Sayaji Jubilee Cotton & Jute Mills Ltd*, (1964) 34 Comp Cas 777: AIR 1965 Guj 96: (1964) 5 Guj LR 804.

21 *Ratan Chand Jain* v *Uberoi Ltd*, [1992] 2 Comp LJ 202 Delhi.

22 *T. M. Paul (Dr)* v *City Hospital (P) Ltd*, (1999) 97 Comp Cas 216 Ker, meeting was called at a time when some directors were unable to attend, resolutions passed at such meetings were held to be void.

23 *Allahabad Bank* v *Canara Bank*, (2000) 101 Comp Cas 64 SC, exclusive jurisdiction of Debt Recovery Tribunal.

24 *K. Venkat Rao* v *Rockwool (India) Ltd*, (2002) 108 Comp Cas 494 AP, FB, for example, a decision as to whether any of the disqualifying clauses of S. 283 have operated.

25 (2000) 5 SCC 601: AIR 2000 SC 2427.

There is no provision in the Companies Act conferring jurisdiction on the High Courts to entertain applications relating to forfeiture of shares.[26]

Powers of Securities and Exchange Board of India [S. 55-A]

The new provision as to the powers of SEBI under the Companies Act as inserted by the amendment of 2000 (Jan 14, 2001) is as follows:

"**S. 55-A. Powers of Securities and Exchange Board of India.**—The provisions contained in Sections 55 to 58, 59 to 84, 108, 109, 110, 112, 113, 116, 117, 118, 119, 120, 121, 122, 206, 206-A, 207, so far as they relate to issue and transfer of securities and non-payment of dividend shall,—

(*a*) in case of listed public companies;

(*b*) in case of those public companies which intend to get their securities listed on any recognised stock exchange in India,

be administered by the Securities and Exchange Board of India; and

(*c*) in any other case, be administered by the Central Government.

Explanation.—For removal of doubts, it is hereby declared that all powers relating to all other matters including the matters relating to prospectus, statement in lieu of prospectus, return of allotment, issue of shares and redemption of irredeemable preference shares shall be exercised by the Central Government, Company Law Board or the Registrar of Companies, as the case may be."

These provisions relate to financial aspects and they have been handed over to SEBI's administration.

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26 *Tej Prakash S Dangi* v *Coramandal Pharmaceuticals Ltd*, (2002) 100 Comp Cas 546 AP.

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Kinds of Company

UNLIMITED COMPANIES

One of the main purposes of the Companies Act is to confer upon the business community the privilege of trading with limited liability. Yet the promoters of a company have the choice to form the company with unlimited liability. Section 12 provides that "seven or more persons or where the company to be formed will be a private company, any two or more persons may form an incorporated company with or without limited liability". "The right of limited liability is desirable, but not a necessary adjunct to incorporation."[1] A company not having any limit on the liability of its members is termed an unlimited company.[2]

Companies with unlimited liability are rarely formed now. But such a company is definitely a suitable choice in cases where heavy liabilities are not likely to be incurred and the other advantages of separate corporate personality are desired.

An unlimited company must have articles of association stating the number of members with which the company is to be registered and if the company has a share capital, the amount of share capital with which it is to be registered.[2]

The obvious disadvantage of an unlimited company is that its members are liable, like the partners of a firm, for all its trade debts without any limit. But this does not mean that the creditors of an unlimited company can directly sue the members. Even in this case, the creditors have, if the company fails to pay, to resort to winding up and the liquidator will call upon the members to contribute to the assets of the company so as to enable him to meet the debts and the expenses of winding up.

There are certain advantages also. For example, an unlimited company need not have any share capital. And if it has, it may increase or reduce its capital without any restriction. And, what is more, it may purchase its own shares, as Section 77 does not apply to the case of an unlimited company.[3]

An unlimited company can get itself re-registered as a limited liability company under Section 32 of the Act. The conversion will not affect any debts, liabilities, obligations or contracts of the company existing at the time of conversion and such debts *etc.* will become enforceable under Part IX of the Act.[4]

GUARANTEE COMPANIES

Where it is proposed to register a company with limited liability, the choice is to limit liability by shares or by guarantee. The liability of the members of a guarantee company is limited by a fixed sum which is specified

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1 Leonard W. Hein, *British Business Corporation: Its Origin and Control*, (1963-64) 15 Toronto Law Journal, 134.

2 S. 27(1).

3 S. 77 contains restriction on purchase by a limited company of its own or its holding company's shares. *See* Chap. 9.

4 S. 32(3).

in the memorandum and beyond which they cannot be called upon to contribute. Section 13(3) provides that "the memorandum of a company limited by guarantee shall... state each member undertakes to contribute to the assets of the company in the event of its being wound up, for payment of the debts and liabilities of the company, such amount as may be required not exceeding a specified amount." Further, the articles of association of the company shall state the number of members with which the company is to be registered.[5]

It is not necessary for a guarantee company to have any share capital. But if it has share capital, it is subject to the same restriction as to reductions as the capital of a company limited by shares.[6] It does not also have the liberty to purchase its own shares.[7]

Any provision in the memorandum or articles of the guarantee company or any resolution which purports to give to any person other than a member the right to participate in the divisible profits of the company shall be void.[8]

Any division of the undertaking of the company into shares or interests is regarded as a provision for share capital even if the nominal amount or the number of shares is not specified.[9]

The Supreme Court has emphasised that the right of a guarantee company to refuse to accept the transfer by a member of his interest in the company is on a different footing than that of a company limited by shares. A guarantee company was running a stock exchange. The right of an existing member to transfer his interest to another person would involve the question of that person's admission to the membership of the organisation. Such membership may carry privileges much different from those of ordinary shareholders. The Supreme Court characterised the decision of the High Court that the same principles were applicable as much to transfer of membership as to shares, as wrong. The matter was remitted for reconsideration.[10]

PRIVATE COMPANIES

A private company is a very suitable device for carrying on the business of family and small scale concerns, as the minimum number of members required to form a private company is only two.[11] A private company is defined in Section 3(1)(*iii*). It means a company which in its articles of association contains the following restrictions:

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5 S. 27(2).
6 S. 100.
7 S. 77.
8 This applies to companies registered after April 1, 1914. S. 37(1).
9 S. 27(2).
10 *Narendra Kumar Agarwal* v *Saroj Maloo*, (1995) 6 SCC 114: (1996) 85 Comp Cas 172: (1995) 10 Corpt LA 137: [1995] 5 Comp LJ 34 SC. The Court noted the difference in the set of articles in Sch. I which are applicable to guarantee companies and companies limited by share.
11 S. 12.

1. *Minimum paid up capital*

The company has a minimum paid up capital of one lakh rupees or such higher amount as may be prescribed by its articles.[12]

2. *Restriction on Transferability of Shares*

There must be some restriction on the right of its members to transfer their shares in the company. Any restriction which will enable the directors to maintain the maximum limit of fifty members will serve the purpose of the Act.[13] This restriction is not necessary in the case of a private company not being limited by shares.[14]

3. *Restriction on Membership*

The number of its members must be limited to fifty, which shall be exclusive of members who are or were in the employment of the company. Joint holders of shares shall be treated as a single member.

4. *Prohibition on Issue of Prospectus*

The company must prohibit any invitation to the public to subscribe for any shares in or debentures of the company. The Amendment of 2000 requires that the company should prohibit any invitation or acceptance of deposits from persons other than its members, directors or their relatives.

Existing private companies have to increase the capital to one lakh rupees within two years.[15] The amendment further provides that if a company fails to do so, it would be liable to be struck off the Register of Companies in the manner of a defunct company.

A private company is compulsorily required to have articles of association. They are necessary, if not for anything else, to embody the above restrictions.

Advantages of a private company

The Act applies to private companies in all respects,[16] except where they are expressly exempted from its operation. These exemptions are commonly known as the privileges or advantages of a private company.

It is by virtue of these exemptions that a private company has been described as "an incorporated partnership, combining the advantages of both elements — the privacy of partnership and the permanence and origin of the corporate constitution. Ordinary companies are like bees working in a glass-hive. Private companies can keep their affairs to themselves."[17] Private

12 New requirement introduced by the Companies Amendment Act, 2000.

13 *See* Palmer's COMPANY LAW, 37 (20th Edn, 1959).

14 S. 27(3).

15 To be computed from the enforcement date of the Amendment Act, 2000, w.e.f. Jan 14, 2001.

16 Private companies are legal entities as much as public companies. They cannot be called a property of the joint Hindu family, *Vikas Jalan* v *Nucon Industries P Ltd*, (2001) 103 Comp Cas 343 AP.

17 Edward Manson, *The Evolution of the Private Company*, (1910) 26 LQR 11.

companies exist with the sanction and encouragement of the Legislature.[18] They enjoy the benediction of the Legislature. Some of the advantages may be mentioned here:

1. *Subscription*

The formation of a private company requires only a minimum of two subscribers to the memorandum of association.[19] This, to a large extent, facilitates the formation and harmonious functioning of a private company and makes the choice of such a company most suitable for family or friendly concerns.

2. *Exemption from Prospectus-Provisions*

Public participation by issuing a prospectus is prohibited.[20] A private company is, therefore, exempt from all the requirements of the Act relating to the prospectus. For example, it has not to file a statement in lieu of prospectus;[21] it can proceed to allot shares without having to wait for any such thing as a minimum subscription.[22] It can commence business immediately on incorporation, as it has not to wait to obtain a certificate for commencement of business.[23]

3. *Directors*

Regarding the appointment of directors a private company is entitled to certain beneficial exemptions. For example, it is required to have only two directors.[24] All its directors can be permanent life directors; the requirement of retirement by rotation does not apply.[25] All the directors can be appointed *en bloc* by a single resolution. The special fourteen days' notice required by Section 257(1) for the appointment of a new director in place of a retiring one does not apply to the case of a private company.[26] Again, a public company cannot increase the number of its directors beyond the permissible maximum under its articles as first registered.[27] This restriction does not apply to the case of a private company. No director of a public company can act as a director,[28] unless he has within thirty days of his first appointment signed and filed with the Registrar his consent in writing to act as such a director. This provision of the

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18 *See* YOUNGER LJ in *Commissioner of Indian Revenue* v *Sansom*, [1921] 2 KB 492, 574: 125 LT 37.

19 S. 12.

20 S. 3(1)(*iii*).

21 S. 70(3).

22 This is so because S. 69 which contains prohibition on allotment unless minimum subscription is received applies only to the case of a company which has offered shares to the public for subscription, something a private company is prohibited from doing.

23 S. 149(7).

24 S. 252(2).

25 S. 255(1).

26 S. 257(2).

27 S. 259(*a*)(*b*).

28 Other than a director appointed after retirement by rotation. S. 264(2).

Act does not apply to a private company.[29] Similarly the provision of Section 266(1)(*b*) requiring directors of public companies either to sign memorandum for taking qualification shares or to file with the Registrar an undertaking to take them does not apply to the case of a private company.[30] Restriction as to remuneration also do not apply.[31]

4. *Statutory Meeting*

A private company is exempted from the requirement of holding statutory meeting and filing statutory report.[32]

5. *Further Issue of Capital*

Under Section 81 a public company proposing to increase its subscribed capital by allotment of further shares, must, in certain cases, offer them to the existing members. But the section does not apply to a private company which is, therefore, free to allot new issues to outsiders.[33]

6. *Company an Undisclosed Principal*

According to Section 416 if any agent of a company makes a contract on behalf of the company but keeping the company as an undisclosed principal, he has to make a memorandum in writing of the terms of the contract and specifying the other party to the contract. He has also to deliver the memorandum to the company and send copies to each of the directors so that it may be laid before the board at its next meeting. Private companies are exempted from these requirements.

7. *Disclosure of Interest*

Another important exemption is in Section 300. As has already been seen, this section excludes an interested director from participating in voting at board's proceedings. But, as a private company is exempted from the operation of this section, an interested director is under no obligation to retire from a meeting of the board at which the subject-matter of his interest is discussed. He may participate in the proceeding and exercise his vote.[34]

Conversion of private company into public company

1. *Conversion by Default*

These privileges and exemptions can be enjoyed by a private company only as long as it does comply with the requirements of its definition as detailed in Section 3(1)(*iii*). "When a default is made in complying with any of those provisions, the company shall cease to be entitled to the privileges and exemptions conferred by or under the Act."[35] The whole of the Act

29 S. 264(3).
30 S. 266(5)(*b*).
31 S. 198.
32 S. 165.
33 S. 81(3).
34 S. 300(2).
35 S. 43.

would then apply to the company as if it were not a private company. However, discretion is given to the court to grant relief to the company from such consequences where the court is satisfied that the failure to comply with the conditions was accidental or due to inadvertence or to some other sufficient cause, or that on other grounds it is just and equitable to grant relief.[36] The order of relief is made on the application of the company or any other person interested and on such terms and conditions as seem to the court just and equitable.

2. *Conversion by Operation of Law* [S. 43-A]

Section 43-A has been omitted by the Companies Amendment Act, 2000. It was brought into being for converting compulsorily private companies into deemed public companies in certain circumstances like the amount of turnover and holding of capital to a certain percentage by other public companies, or by the private company in public companies or issue of advertisement for deposits. These provisions having been scrapped, the concept of deemed public company under S. 43-A has disappeared.

The only provision that survives in S. 43-A is sub-section (2-A) inserted by the Amendment of 2000. It became necessary to take care of the fact that a good lot of companies that had become deemed public companies would lapse back into private companies and a provision had to be given for the same. The provision says that when a deemed public company becomes a private company after the amendment of 2000 (Jan 14, 2001), the company has to inform the Registrar and the latter would make necessary changes in his records such as the company's memorandum of association and certificate of incorporation. He has to carry out this process within 4 weeks from the date of the company's application.

3. *Conversion by Choice* [S. 44]

Apart from the above provisions of the Act, a private company may of its own choice become a public company. It may at any time pass a special resolution deleting from its articles the requirements of Section 3(1)(*iii*) and then, from the date of alteration, it becomes a public company.[37] Within thirty days a prospectus or a statement in lieu of a prospectus must be filed with the Registrar,[38] and all other requirements of the Act should be complied with, such as, increasing the number of shareholders and directors to the statutory minimum.

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36 Proviso to S. 43. See, for example, *Laxman Bharmaji* v *Emperor*, AIR 1946 Bom 18: 223 IC 110, where a private company issued debentures to the public and therefore, became a public company. Its officers were penalised for failure to file Profit and Loss Account and Balance-Sheet with the Registrar.

37 S. 44(1).

38 S. 44(1)(*b*). See *Hindustan Lever* v *Bombay Soda Factory*, AIR 1964 Mys 173. A failure in this respect would entail a daily fine of Rs 500 for all defaulting officers till the default is made good. If the statement in lieu of prospectus which has to be filed carries a misleading statement, the guilty officers would be punishable with imprisonment up to 2 years or fine up to Rs 50,000 or both.

Conversion of public company into private company

A public company can also be converted into a private company. For this purpose it will be necessary to pass a special resolution by which the articles of the company shall be changed so as to include the requirements of a private company as prescribed in Section 3(1)(*iii*). But Section 31(1) provides that "no alteration made in the articles which has the effect of converting a public into a private company shall have effect unless such alteration has been approved by the Central Government". But confirmation of the court is not necessary.[39]

The conversion of a company from private to public or *vice versa*, does not change the identity of the company.[40]

FOREIGN COMPANIES

A foreign company means a company incorporated outside India. But for the purpose of Section 591, it means a company, which, though incorporated outside India, has a place of business in India. The meaning of the expression "place of business" has been judicially construed. The court considered the extent of business which has to be carried on to make "a place of business" for the purpose, in that case, to establish a sufficient presence within the jurisdiction for service of process.[41] A Canadian railway company's four directors were in England who formed a London Committee for the purpose of raising loans for the construction of the railway in Canada. They were using the office of another company without rent and transacted no other business than that of raising loans. The Court of Appeal held that the defendants were carrying on their business in the office used by the London Committee and could therefore be properly served with a writ. In the pictorial words of BUCKLEY LJ:[42]

> We have only to see whether the corporation is "here"; if it is, it can be served. The best test is to ascertain whether the business is carried on here and at a defined place. In the present case the company has a paramount, and also a subsidiary object: its paramount object is to make and run a railway in Canada, to do which a great many things must first happen: it has a subsidiary object, namely, the raising of money to carry out its paramount object. The raising of this loan capital is part of the company's business, and it is done here by a London Committee constituted of the directors resident in England.

Similarly, where an overseas bank hired premises in England, had some staff there for the purpose of conducting external trade and financial relations, that was held to be a place of business, though no actual banking transaction was taken up there.[43] A company established no office in England, but enlisted 5000 residents in the UK as members of its Titan Business Club so as to enable them

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39 *Radiant Chemical Co, Re*, AIR 1943 Pat 278.

40 *All India Reporter Ltd* v *Ramchandra*, AIR 1961 Bom 29: ILR 1961 Bom 257. Legal proceedings instituted before conversion can continue, *Solver Oils and Fertilisers* v *Bhandari Cross-fields*, (1978) 48 Comp Cas 260 P&H.

41 *A/s Dampskib 'Hercules'* v *Grand Trunk Pacific Rly Co*, [1912] 1 KB 222.

42 At 223, *ibid.*

43 *South India Shipping Corpn Ltd* v *Export Import Bank of Korea*, [1985] 2 All ER 219 Ch D.

to earn by chain system. This was held to be sufficient to give jurisdiction to the English courts to entertain a petition for winding up a foreign company. The company's employees were restrained from remitting any funds to Germany.[44] But where a foreign company posted a representative in India only for the purpose of eliciting orders from the company's customers, that was held to be not establishing a place of business in India. The court said that there should be a fixed and definite place where the business-like operations are carried on for a reasonably long period of time.[45]

If a winding up order is passed, the court would get jurisdiction to restrain any act which would not be lawful. The court restrained recovery under a foreign decree from the company's business in England on a finding that the decree holder was not entitled to the sum awarded to him by a US Court.[46] Such a company has to furnish to the Registrar the following documents[47] within thirty days:

1. A certified copy of the charter, statutes or memorandum and articles or any instrument containing the constitution of the company. If the instrument is not in English language, a certified translation of it will have to be filed.
2. The full address of the registered or principal office of the company abroad.
3. A list of the directors of the company. In the case of an individual director, his name in full, his usual residential address, his nationality of origin, his business, occupation and particulars of other directorships held by him should be given. If a body corporate is a director, its corporate name and registered or principal office; and the full name, address, nationality of origin, if different from the nationality, of each of its directors must be specified. If the secretary is an individual, his present name and his usual residential address should be indicated and in the case of a body corporate, its corporate name and registered or principal office.[48]
4. A similar information about the secretary of the company.
5. The name and address or the names and addresses of some one or more persons resident in India, authorised to accept on behalf of the company service of process and any notices or other documents required to be served on the company. Any document, *etc.* served on

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44 *Senator Hanseatische Verwattungsgesllseschaft*, (1996) 2 BCLC 562. The money could thus be captured for the purpose of paying back the contributors, *One life Ltd* v *Roy*, (1996) 2 BCLC 608 Ch D. *Deflin International (SA) Ltd Re*, [2000] 2 BCLC 71 Ch D, scheme found to be lottery, winding up ordered.

45 *P. J. Johnson* v *Astrofiel Armadorn*, [1989] 3 Comp LJ 5, 10 Ker.

46 *Mitchell* v *Carter*, (1997) 1 BCLC 673 Ch D and CA.

47 S. 592. A foreign company cannot be sued in India for a cause of action which has arisen wholly outside India even if it has a place of business in India. So held by the Bombay High Court in *Partap Singh* v *Bank of America*, (1976) 46 Comp Cas 532 Bom. Residence in India in not established by merely posting a representative hired for seeking orders. *P. J. Johnson* v *Astrofiel Armadorn*, [1989] 3 Comp LJ 5, 10 Ker.

48 S. 592(2).

such a person shall be deemed to have been served on the company. Where no such person is designated the service may be left at the company's principal place of business.[49]

6. The full address of the office of the company in India which is to be deemed its principal place of business in India.[50]

When any change occurs in the above particulars the Registrar must be notified accordingly.[51]

Such documents have to be filed at two places, first, with the Registrar of the State where the principal place of business is situate and, second, with the Registrar at New Delhi.[52]

If the company establishes any branch or branches of its business in India, no further information need be given, except that with the annual accounts the company should deliver three copies of a list of all its places of business in India and with reference to which the accounts are made out.[53]

A foreign company is further bound by the following obligations:

1. The company shall conspicuously exhibit on the outside of every office or place of business its name and the country of incorporation in English characters and in the regional language. The statement must also show whether the liability of the members is limited.
2. The name and the country of incorporation should also appear in English on all business letters, bill-heads and letter papers and on all notices and other official publications of the company. The statement must also indicate whether the liability of the members is limited.

A failure to comply with the above provisions does not affect the validity of any contract made by a foreign company, but "the company shall not be entitled to bring any suit, claim any set-off, make any counter-claim or institute any legal proceeding in respect of any such contract until it has complied with all the provisions of the Act relating to foreign companies".[54]

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49 S. 596. Service of notices of a writ on persons whose names were recorded in the Registrar's files was held to be sufficient though the company had closed its foreign branch and the employees had left for India. See *Rome* v *PNB, (No. 2)*, [1990] 1 All ER 59 CA.

50 Where the writ to be served on the company was not addressed to the person named for service of the company, service was held to be not effected in accordance with the legal requirements. But because the writ was posted to the right address and it was also served, the court, in its discretion, held the service to be good, *Boocock* v *Hilton International Co*, [1993] 4 All ER 19 CA.

51 S. 593.

52 S. 597. Non-compliance with the Act is punishable under S. 598 with a fine extending up to Rs 10,000, and, in the case of a continuing offence, with an additional fine which may extend up to Rs 1000 for every day during which the default continues.

53 S. 594(3).

54 S. 599. If the Indian branch of a foreign company changes its objects, the court in whose jurisdiction its place of business is located will have jurisdiction to try shareholders' objections. *F. R. Paymaster* v *British Burmah Petroleum Co*, (1976) 46 Comp Cas 587 Bom.

Accounts of Foreign Company

The obligations of a foreign company in respect of accounts are almost the same as those of a company registered under the Indian Act, for Section 594 provides that "every foreign company shall in every calendar year make out a balance-sheet and profit and loss account in such form, containing such particulars, including such documents (in particular, documents relating to every subsidiary of the foreign company) as, under the provisions of this Act it would, if it had been a company within the meaning of this Act, have been required to make out and lay before the company in a general meeting and deliver three copies of these documents to the Registrar". Separate balance-sheet and profit and loss account in respect of the company's Indian business should be prepared and submitted along with a copy of the company's world business. Three copies of the accounts have to be filed with the Registrar. However, the Central Government has the discretion to exempt a foreign company from this obligation.[55]

Further, Section 600(3) requires a foreign company to maintain books of account referred to in Section 209[56] "with respect to moneys received and expended, sales and purchases made and liabilities in the course of, or in relation to its business in India."

Prospectus of Foreign Company

A foreign company may, even if it has no place of business in India, issue a prospectus offering shares or debentures for subscription. The prospectus shall have to comply with the provisions of the Act relating to prospectus.[57] For instance, it shall have to state the matters specified in Part 1 of Schedule II; the report set out in Part 2 of that Schedule, subject to the provisions of Part 3.[58] It must also be registered with the Registrar before it is issued.[59] The liability for mis-statements is also the same as in the case of a prospectus issued by an Indian company.[60] In addition, however, to the general requirements of the Act, the prospectus of a foreign company has to contain particulars with respect to the following matters:[61]

(*a*) the instrument containing or defining the constitution of the company;

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55 Proviso to sub-section (1) of S. 594.

56 *See* Chapter on Audit and Accounts. S. 601 gives some guidance about fee payable and S. 602 as to the meaning of some terms.

57 Ss. 603 to 608. Section 606 contain penalty for contravention of Sections 603, 604 and 605 and is as follows:

"Any person who is knowingly responsible—

(*a*) for the issue, circulation or distribution of a prospectus; or

(*b*) for the issue of a form of application for shares or debentures or Indian Depository Receipt;

in contravention of any of the provisions of Sections 603, 604, 605 and 605-A, shall be punishable with imprisonment for a term which may extend to six months, or with fine which may extend to [*fifty thousand rupees*], or with both."

58 S. 603(*i*)(*b*).

59 S. 605.

60 S. 607.

61 S. 603(*i*)(*a*).

(*b*) the provision of law under which the company was incorporated;

(*c*) an address in India where the above instrument and the provisions of law may be inspected. If they are not in the English language, a certified English copy should be made available;

(*d*) the date and the country of incorporation;[62]

(*e*) whether the company has established a place of business in India and, if so, the address of its principal office in India.

The Companies (Amendment) Act, 1974, reduced Section 591 into Section 591(1) and inserted sub-section (2). The effect of the amendment is that in the case of a foreign company having a place of business in India, if 51% of the paid-up share capital, whether preference or equity is in Indian hands, it shall have to comply with such of the provisions of the Act as may be prescribed as if it were a company incorporated in India.

By an amendment of Section 600, the provisions of Section 159 have been extended to foreign companies subject to such modifications and adaptations as may be made by rules drafted under the Act. Section 159 requires filing of annual returns. Similarly, the provisions of Sections 209-A, 233-B and 234 to 246 have been made applicable to the Indian business of a foreign company. Section 209-A contains provisions about inspection of accounts. Section 233-A empowers the Government to direct special audit, and Section 233-B, audit of cost accounts. Sections 234 to 246 provide for investigations.[63]

Offer of Indian Depository Receipts [S. 605-A]

The Central Government has been authorised by the section to make rules applicable for

(*a*) the offer of Indian Depository Receipts;

(*b*) the requirement of disclosures in prospectus or letter of offer issued in connection with Indian Depository Receipts;

(*c*) the manner in which the Indian Depository Receipts shall be dealt in a depository mode and by custodian and underwriters;

(*d*) the manner of sale, transfer or transmission of Indian Depository Receipts,

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62 See also S. 595(*a*).

63 For income tax purposes, it has been held by the Calcutta High Court in *Hunger Ford Investment Trust Ltd* v *ITO*, (1977) 47 Comp Cas 181, that a director functioning in India may be regarded as a principal officer. For purposes of liability in the host State as to when a foreign company is to be regarded as an instrumentality of the foreign State so as to require Government permission under S. 86 of the Civil Procedure Code before instituting proceedings, the court said that the Government should examine the question objectively and permit proceedings in civil matters of contractual or tortuous nature. *Veb Deut Nackt Seereederi Roetech* v *New Central Jute Mills*, [1994] 1 Comp LJ 138 SC. All the activities of a government company are not to be held as those of an instrumentality of the State, *Panchra Mayurakshi Cotton Mill Employees* v *State of WB*, (1993) 2 Cal LJ 176.

by a company incorporated, or to be incorporated outside India, whether the company has or has not been established or, will or will not establish any place of business in India.

GOVERNMENT COMPANIES[64] [S. 617]

A Government company is thus defined in Section 617:

> For the purposes of this Act, Government company means any company in which not less than fifty-one per cent of the paid-up share capital is held by the Central Government, or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments and includes a company which is the subsidiary of a company as thus defined.[65]

Takeover of the management of a company by the Central Government under the provisions of the Industries Development and Regulation Act, 1951 does not have the effect of converting the company into a Government company.[66]

Following are the special provisions of the Act relating to Government companies:

"The auditor of a Government company shall be appointed or re-appointed by the Comptroller and Auditor General of India",[67] who will also have the power to direct the manner in which the accounts of the company shall be audited and give the auditor instructions in regard to any matter relating to the performance of his functions. The Comptroller and Auditor General is also given the power to conduct a supplementary or test audit of the company's accounts by such person or persons as he may authorise in this behalf,[68] and to

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64 For a study relating to Government companies, *see* Shradha Kumari, *Government Companies in India*, (1957) ILJ 143.

65 A Government company is not an extension of the State. It is as much bound by the tax structure as any other company. See *Bharat Aluminium Co Ltd* v *Special Area Development Authority*, (1981) 51 Comp Cas 184 MP; *K. M. Thomas* v *Cochin Refineries Ltd*, (1985) 58 Comp Cas 48 Ker. But a Government company is growingly being regarded as an instrumentality of the State and as such amenable to writ jurisdiction even in the matter of its commercial bargains because it has to act fairly in trade matters also. See *Mahabir Auto Stores* v *IOC*, (1990) 3 SCC 752: (1990) 69 Comp Cas 646 SC, where the IOC was prevented by means of a writ from cancelling without proper procedure an 18-year old distributing agency. Shareholding to the extent of 50% only would not make a Government company. The Govt. otherwise also had no control over the functioning of the company. Writ against termination of employee's services not allowed. *T. M. Devassy* v *Periyar Latex (P) Ltd*, (1994) 81 Comp Cas 560 Ker. *Balco Employees' Union* v *Union of India*, (2002) 108 Comp Cas 193 SC, no interference in the policy of disinvestment unless some illegality or *malafides* shown. Employees also cannot complain. In a subsequent ruling in the context of *Hindustan Petroleum*, the Supreme Court revised its approach to such cases and emphasised that Parliament must be taken into confidence.

66 *Kulbir Singh* v *Union of India*, (1997) 88 Comp Cas 586 Delhi. *Phoenix Neuro Relaxation Service Ltd* v *Estate Officer*, (1996) 2 Cal HN 440 Cal, a Government company (in this case ITDC) is within the category of Government for eviction under Public Premises (Eviction of Unauthorised Occupants) Act, 1971.

67 S. 619(2).

68 S. 619(3).

require information for the purpose of such audit.[69] The auditor is required to submit a copy of his audit report to the Comptroller and Auditor General of India who shall have the right to comment upon or supplement the audit report.[70] Any such comments or supplements shall be placed before the annual general meeting of the company along with the audit report.[71] Where the Central Government is a member of a Government company, it is the duty of the Central Government to prepare an annual report on the working and affairs of the company. The report must be ready within three months of the company's annual general meeting before which the audit report is placed.

The report is to be laid before both Houses of Parliament together with a copy of the audit report and the comments, if any, of the Comptroller and Auditor General of India.[72] Where, in addition to the Central Government, a State Government is also a member of the company, the State Government shall lay the same report before the State Legislature.[73] But where the Central Government is not a member, every State Government which is a member shall have to prepare an annual report within the same time and then, as soon as may be, lay it before the State Legislature.[74]

Section 619-A(4), introduced by the amendment of 1988, provides that the provisions of the section (regarding annual report on Government Companies) shall also apply to a Government company in liquidation.

Section 620 gives the power to the Central Government to declare by notification in the Official Gazette that any of the provisions of the Act shall not apply to any Government company or which provisions shall apply to any such company. The notification shall be effective to the extent to which it is approved of by Parliament.[75]

In the absence of any such exemption, the whole Act applies to Government companies.[76] The position is explained by the Calcutta High Court in its decision in *River Steam Navigation Co Ltd, Re*[77]. The River Steam Navigation Co was incorporated in England and was carrying on river transport between Calcutta and Assam. Its business suffered a severe setback in the Indo-Pak conflict. The Government considered the service to be of strategic importance and, therefore, backed the company with financial assistance. The company also

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69 S. 619(3)(*b*).

70 S. 619(4).

71 S. 619(5).

72 S. 619-A(*i*).

73 S. 619-A(2).

74 S. 619-A(3). For an account of the restrictions on the functioning of a Government company, see *S.K. Debnath* v *Mining & Allied Machinery Corpn*, [1968] 1 Comp LJ 214.

75 S. 620(2) as amended by the Amendment Act of 1977 now provides that a copy of every such notification shall be laid before each House of Parliament for 30 days and if both Houses agree in disapproving or modifying the notification, then it shall not be issued or issued as modified.

76 Thus a Government company was held bound by the provisions of its articles according to which the President had the power to give a binding advice to the company. *G. D. Zalani* v *Union of India*, 1995 Supp (2) SCC 512: (1995) 84 Comp Cas 40 SC. The court did not interfere in a business decision of the managing director in selecting a collaborator because the presumption of good faith was borne out by the facts.

77 [1967] 2 Comp LJ 106 Cal.

borrowed from its bankers. But even then it was not able to stand on its own feet. The Government, in order to assure the continuity of the service, acquired a majority of its shares. But even this massive backing was not equal to the debt burden of the company. Schemes of compromise and arrangement were then drawn up which were supported by all the parties concerned except one creditor who had applied for a winding up order. The company applied for the court's sanction to the schemes. P. B. MUKHARJI J had to deal with a number of technical objections. When a majority of the shares of a foreign company are acquired by the Government, does it become a Government company? The learned Judge found that the company, as it stood, satisfied the definitions both of a Government company, under Section 617 and of a foreign company under Section 591, so that it was, at the same time, a Government as well as a foreign company. Since this ruling would have created many absurdities, the court held that the company must be considered as a Government company.[78]

The second technical objection related to the jurisdiction of the Calcutta High Court. The company was not registered in India. It had no registered office in India. It should, therefore, have no right to apply under Section 391. The court overruled this objection by holding that such a company falls within the definition of "unregistered company" under Section 582(*b*), and Section 583(2) provides that for the purpose of jurisdiction the company shall be deemed to be registered in the State where its principal place of business is situate. Explaining the same the learned Judge said:

> If a Government company is incorporated and registered outside India, such a Government company comes within the definition of an "unregistered company" under Section 582(*b*) and all the provisions of Part X consisting of Sections 582 to 590 shall apply *mutatis mutandis* to such a Government company which do not militate against any special provisions for Government companies in Sections 617, 618, 619, 619-A and 620 of the Companies Act.

The next argument was that a Government company should not be permitted to float a scheme of compromise under Section 391 and this for two reasons, firstly, that such schemes originated as an alternative to winding up and a Government company cannot be wound up by the court and secondly, the Government can at any time set at naught the jurisdiction of the court by a notification that Government companies are exempt from the operation of Section 391. The court could not obviously approve of these objections. At the date of the scheme the Government had not issued any such notification and *minus* such exemptions the whole of the Companies Act is applicable to Government companies.

Referring to the argument that a Government company cannot be wound up, the learned Judge said:

> When the Government engages in trading ventures and particularly as Government companies under the Company Law, it does not do so as a

78 The court pierced the veil of incorporation for this purpose and finding that majority shares were in the hands of the State regarded the company as a Government company. *See* at 119, *id.*

political State but it does so, in garb and essence, as a company. The Government company, therefore, is a class of company and is not to be placed on the same pedestal as a State or Government....

A Government company may have to tide over certain difficulties as a trading institution under the Company Law or it may be required to be wound up for distribution of its assets in certain contingencies. There is, therefore, no justification for holding that a Government company because it is a Government company cannot work under a scheme in an appropriate context. To wind up a Government company or to work a Government company under a scheme is not to wind up the Government but a Government institution trading under the Company Law.

Continuing further, the learned Judge added, that—

...to subscribe to the view that a Government company cannot be wound up or work under a scheme would mean that it is a kind of a perpetual company and once established can neither be extinguished nor work under an arrangement with its members and creditors.

Once the technical considerations were overcome, the only thing that the court had to consider was the fairness of the scheme and as to this it had no doubt:

Balancing all the interests and considerations involved this is the picture which emerges. A large majority of the creditors, secured and unsecured, and the members want the scheme to be accepted. Public and national interest, as well as the interest of the labour and staff demand that a scheme should be evolved to work out the equities between different groups. Except the solitary unsecured creditor, J.S. Desai & Co, every interest represented before me considers that liquidation on such facts will be highly detrimental and prejudicial to all concerned.

The Amendment Act, 1974, has enlarged the concept of "Government company" for the purposes of audit. Section 619-B has been inserted for this purpose. This section says that the provisions of Section 619 (which deals with audit of Government companies) shall apply to a company in which at least 51% of the paid-up share capital is held by the following or any combination thereof:

1. the Central Government and one or more Government companies;
2. any State Government or Governments and one or more Government companies;
3. the Central Government, one or more State Governments and one or more Government companies;
4. the Central Government and one or more corporations owned or controlled by the Central Government;
5. the Central Government, one or more State Governments and one or more corporations owned or controlled by the Central Government;
6. one or more corporations owned or controlled by the Central Government or any State Government;[79]

79 Corporations of this kind are included within the meaning of the expression "public financial

7. more than one Government company.

Holding company and subsidiary [S. 4]

Where one company has control over another, it is known as the holding company and the company over which control is exercised is called the subsidiary company. This control of one company over another may, within the meaning of Section 4, be held in one of the following three ways.

Firstly, where one company controls the composition of the Board of directors of another, the latter becomes the subsidiary of the former.[80] The composition of the Board of directors of a company shall be deemed to be controlled by another if the latter has the power, without the consent or concurrence of any other person, to appoint or remove the holders of all or a majority of the directorships. And a company shall be deemed to have the power to appoint to a directorship in the following three cases:

1. If a person cannot be appointed to a directorship without the exercise in his favour of the power of appointment held by the company.
2. If a person's appointment to directorship follows necessarily from his appointment as director, managing agent, secretaries and treasurers or manager or to any other office or employment in the company.
3. If the directorship is held by an individual nominated by the company or by any of its subsidiaries.

Secondly, where one company holds the majority of shares in another company, the latter becomes the subsidiary of the former. In ordinary cases, "majority shareholding" means holding more than half in nominal value of the equity share capital of a company. But where a company has preference shareholders who had, before the commencement of the Act of 1956 and, therefore, still have, "the same voting rights in all respects as the holders of equity shares", it will be necessary, for the purpose of becoming a majority shareholder, to exercise or control more than half of the total voting power of such a company.

Thirdly, where one company is subsidiary of another, which is itself a subsidiary of some other company, the first mentioned company shall also become the subsidiary of the last mentioned company. For example the section contains this illustration:

Company 'B' is a subsidiary of Company 'A', and Company 'C' is a subsidiary of Company 'B'. Company 'C' is a subsidiary of Company 'A'.

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institutions" of which the first list is given in S. 4-A but many more have been added to the list by exercising the power conferred under the section. The disinvestment policy of a Government company cannot be questioned by employees even if it would have the effect of converting the company into a private sector company. The employees would remain the employees of the same company as before. *Southern Structurals Staff Union* v *Management of Southern Structurals Ltd*, (1994) 81 Comp Cas 389 Mad.

80 The fact that the majority of directors will remain on the Board only upto the next annual meeting is not material. The relationship of holding and subsidiary is established at least for the time being. See *M. Velayudhan* v *Registrar of Companies*, (1980) 50 Comp Cas 33 Ker. On the holding company's power of appointing directors see *Oriental Industrial Investment Corporation Ltd* v *Union of India*, (1981) 51 Comp Cas 487 Delhi.

If Company 'D' is a subsidiary of Company 'C', Company 'D' will be subsidiary of Company 'B' and consequently also of Company 'A' and so on.

The above conditions will be deemed to have been satisfied, even if the majority of shares are held or the power of appointment to directorship is exercisable by any person as a nominee of the holding company or as a nominee of any of its subsidiaries. But the section provides that in determining whether one company is a subsidiary of another, shares held or power exercisable in the following three cases shall be disregarded:

1. Where the shares are held or the power is exercisable by the company in a fiduciary capacity.
2. Where the shares are held or the power is exercisable by any person by virtue of the provisions of any debentures or of a trust deed for securing any issue of such debentures.
3. Where the shares are held or the power is exercisable by a lending company by way of security and only for purposes of a transaction entered into in the ordinary course of business.

Involvement of S. 372-A

Investment by one company in the shares of another company to the extent of majority shareholding comes into conflict with the restrictions on inter-corporate investments envisaged under S. 372-A. That is why S. 372-A(8)(*c*), (*d*) and (*e*) exempts a holding company from the operation of the section and makes it free to invest any amount in the shares of its subsidiary. But at the time when first investment takes place beyond the limits of S. 372-A, the investee company is not a subsidiary. It would become subsidiary only after the investment. If the investment is within the limits of S. 372-A and that investment itself gives a majority status to the investing company, the formalities and approvals prescribed by S. 372-A would not apply. Where the investment goes beyond those limits, a special resolution would be necessary. After thus gaining the status of a holding company, Section 372-A would not apply on further investments in the subsidiary. The exemption from the operation of S. 372-A is not available to a Board-controlled subsidiary. The 1988 amendment withdrew this privilege. It was being abused by establishing a temporary control over the Board of directors and then enjoying the freedom of investment to any amount, and thus by-passing S. 372 as it was before the amendment of 2000.

Accounts of Holding Company

Sections 212 to 214 contain special provisions about holding and subsidiary companies. Section 212(1) provides that "there shall be attached to the balance-sheet of a holding company the following documents in respect of each subsidiary":

1. A copy of the balance-sheet of the subsidiary. The balance-sheet must be made out in accordance with the requirements of the Act as at the end of the financial year of the subsidiary, where such financial year coincides with the financial year of the holding company. But where

they do not coincide, the balance-sheet must be prepared as at the end of the financial year of the subsidiary last before that of the holding company. But the gap between the two financial years must not exceed six months.[81]

2. A copy of the profit and loss account of the subsidiary prepared in accordance with the provisions of the Act for the same period.[82]
3. A copy of the report of its board of directors made out in accordance with the requirements of the Act and for the period referred to above.[83]
4. A copy of the report of its auditors.[84]
5. A statement of the holding company's interest in the subsidiary at the end of the financial year.[85] The statement shall specify the net aggregate of the subsidiary's profits after deducting its losses at the end of the financial year and also for the financial years since it became a subsidiary, but only so far as it concerns the members of the holding company and is not dealt with in the company's accounts. If the profits of the subsidiary are dealt within the holding company's accounts or a provision is made for any losses, the net aggregate amount of the same must be disclosed. This will be necessary only for such profits and losses of the subsidiary which may properly be treated in the holding company's accounts as revenue profits or losses. Profits or losses attributable to any shares held in the subsidiary company and arising before the shares were acquired by the holding company need not be so treated, except where the holding company is itself the subsidiary of another body corporate and the shares were acquired from that body corporate or a subsidiary of it.[86]
6. If, for any reason, the board of directors of the holding company is unable to obtain information on any of the above matters, a report in writing to that effect must be attached to the balance-sheet of the holding company.[87]
7. Where the financial year of the subsidiary does not coincide with the financial year of the holding company a statement has to be attached showing any change in the holding company's interest in the subsidiary taking place between the gap of the two companies' financial years. The statement must disclose the details of the material changes in the subsidiary's fixed assets, its investments, the moneys lent by it, the moneys borrowed by it for any purpose other than that of meeting current liabilities.[88]

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81 S. 212(2).
82 S. 212(1)(*b*) and (2)(*b*).
83 S. 212 (1)(*c*).
84 S. 212(1)(*d*).
85 S. 212(1)(*c*)
86 S. 212(4).
87 S. 212(6).
88 A holding company and its subsidiaries may be regarded as one group for bonus purposes. See *K C P Ltd* v *Employees*, AIR 1969 Mad 370: 18 FLR 52: 1969 Lab IC 1310.

Inspection of subsidiary's books of account

Section 214 provides that "a holding company may, by resolution, authorise representatives named in the resolution to inspect books of account kept by any of its subsidiaries; and the books... shall be open to inspection by those representatives at any time during business hours".[89]

Investment in Holding Company [S. 42]

A subsidiary company is not allowed to acquire membership of its holding company. Consequently, "any allotment or transfer of shares in a company to its subsidiary shall be void". If the holding company is a guarantee or unlimited company, the above restriction will apply to whatever interest the subsidiary company has in it, whether it is in the form of shares or not.[90] The prohibition also extends up to the nominees of the subsidiary company.[91]

The prohibition does not apply to the case of a subsidiary company which already had shares in its holding company at the commencement of the Act or before becoming a subsidiary of the holding company.[92] The section does not apply to the following cases:[93]

1. Where the subsidiary is concerned as a legal representative of a deceased member of the holding company.
2. Where the subsidiary is concerned as a trustee. This exception will not apply where the holding company itself or any of its other subsidiaries is beneficially interested under the trust, except when its interest is only for the purpose of a security for a transaction, including lending of money, entered into in the ordinary course of business.

A subsidiary can buy shares in its holding company where it is a part of a scheme of amalgamation sanctioned by the court.[94]

Illegal associations [S. 11]

An important aim of the Companies Act is to eliminate the evils caused by large partnerships trading in unincorporated form. A business association consisting of a large number of members, unless incorporated as a company, leads to inevitable confusion and uncertainty concerning the rights and liabilities of members *inter se* and their relations with others. It is, therefore, necessary to provide that every business association having a certain number of members must be registered as a company, failing which it shall be regarded as an illegal association. Accordingly, Section 11(2) declares that no company, association or

89 Sub-section (5): *see* also S. 213 which gives the Central Government the power to adjust the financial years of holding and subsidiary companies.
90 S. 42(5).
91 S. 42(4).
92 S. 42(3).
93 S. 42(2).
94 *Himachal Telematics Ltd* v *Himachal Futuristic Communications Ltd*, (1996) 86 Comp Cas 325 Delhi.

partnership consisting of more than twenty persons[1] (ten in the case of banking business) shall be formed for the purpose of carrying on any business that has for its objects the acquisition of gain for itself or for its members unless it is registered as a company under the Companies Act or is formed in pursuance of some other Indian law.[2] If it is not so registered it becomes an illegal association. The conditions of illegality under the section are:

1. the membership of the association must be more than twenty (or ten in the case of banking business);
2. the association must have been formed for the purpose of carrying on a business;
3. the object of the association must be to acquire profits (gain) for itself or for its members;[3] and
4. the association must not have been registered as a company under the Companies Act, nor must it have been formed in pursuance of some other Indian law.[4]

Thus, for example, a stock exchange has been held to be not in the purview of the section as it is not formed for the purpose of carrying on any business much less a business which has for its objects the acquisition of gain.[5]

The section, however, does not apply to a joint Hindu family carrying on business.[6] Where a business is carried on by two or more joint Hindu families, in computing the number of members for the purposes of this section, minor members must be excluded.[7]

Following are some of the consequences of illegality:

Firstly, according to sub-section (4) every member of such an association shall be personally liable for all liabilities incurred in the business.[8] Apart from

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1 The word "person" would include a company or a corporate person also, though a company joining an association would count only as one person. The confusion caused by the earlier judicial opinion that the word "person" would include only individuals and not bodies of individuals was lifted by subsequent decisions. *Kapurchand* v *Pannaji Devichand*, AIR 1930 PC 300: 34 Cal WN 1107: 59 Mad LJ 435; *Sri Murugan Oil Industries (P) Ltd* v *A. V. Suryanarayanan Chettiar*, (1963) 33 Comp Cas 833: [1963] 1 Comp LJ 158 Mad.

2 This would also include associations recognised by Indian laws. *Ilfracombe Permanent Mutual Benefit Building Society, Re*, [1901] 1 Ch 102.

3 The disabilities inflicted by the section are restricted to associations of commercial or business nature. Associations for charity, advancement of religion, education, research, literature or recreation clubs would be outside the scope of the section. *IRC* v *Korean Syndicate Ltd*, [1920] 1 KB 598, on appeal [1921] 3 KB 258; *Armour* v *Corporation of Liverpool*, [1939] 1 All ER 363 Ch D; *Tan Waing* v *Bottein*, (1933) 3 Comp Cas 112 : AIR 1932 Rang 167; *Dayal Singh* v *Desraj*, [1963] 1 Comp LJ 100 Punj.

4 These essential points have been explained by MODY J in *V. V. Ruia* v *S. Dalmia*, AIR 1968 Bom 347, 350: [1968] 1 Comp LJ 226: (1968) 38 Comp Cas 572.

5 *V. V. Ruia* v *S. Dalmia*, AIR 1968 Bom 347 : [1968] 1 Comp LJ 226 : (1968) 38 Comp Cas 572.

6 Members of a family carrying on business as partners would be covered by the section. *Syamlal Roy* v *Madhusudan Roy*, AIR 1959 Cal 380

7 S. 11(3). *Agarwal & Co* v *CIT*, (1990) 77 ITR 10.

8 See *Kumaraswami Chettiar* v *M. S. M. Chettiar*, AIR 1951 Mad 291 : [1950] 2 Mad LJ 453 : (1950) 20 Comp Cas 286.

this unlimited personal liability, members are punishable with a fine which may extend up to ten thousand rupees.[9]

Secondly, the members of an illegal company cannot maintain an action in respect of any contract made by it. For example, the price of any goods sold by the association cannot be recovered.[10]

Thirdly, it cannot be wound up under the Act even under the provisions relating to winding up of unregistered companies.[11]

Lastly, can there be a suit between members for partition or dissolution or taking of accounts of an illegal company? This question arose before the High Court of Allahabad in *Mewa Ram* v *Ram Gopal*[12]:

> The suit was in respect of a partnership concerned with certain ginning factories. There were more than twenty partners and, therefore, the partnership was illegal. The plaintiff, claiming an eighth share in the partnership, brought an action for a declaration that the partnership was invalid and prayed for a refund of his subscription out of the proceeds realised by an auction sale of the factories or for a division of the properties of the factories.

The case was first heard by a Division Bench consisting of SULAIMAN J (afterwards CJ) and MUKHERJI J. The learned Judges differed. SULAIMAN J was of the opinion that the prayer for a refund of the original subscription could not be granted because the plaintiff had been participating in the profits of the illegal partnership for several years. But he held that the plaintiff was entitled to a partition of the properties.

MUKHERJI J on the other hand, held that the plaintiff was not entitled to any relief, because partition would involve realisation of the assets of the company and payment of its debts, the very things which would be done in a suit for dissolution of partnership or winding up of a company. The case was therefore referred to WALSH J who agreed with MUKHERJI J that a decree for partition would be in substance a direction for winding up or a decree for dissolution of accounts. He added that when such a precedent was once established there was nothing to prevent the formation of an unlimited number of such associations consisting of more than twenty persons carrying on trade for the purpose of gain, any one of the members of which could come to the court and ask for relief in a suit, in the nature of a winding up, for partition of the assets of the association. The result would be to give such associations under another guise the cloak of legality although the statute has forbidden it.

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9 For the purpose of penalty whether the association should be illegal in its inception or whether those also would be covered who subsequently become so, on a minor member becoming major, see *Niraban* v *Lalit*, ILR [1938] 2 Cal 368; AIR 1939 Cal 187.

10 Nor any other property can be recovered. *Jennings* v *Hammond*, (1882) 9 QBD 225.

11 Nor it can be sued, though individual members can be sued for anything received by them on behalf of the association. *Padstow Total Loss and Collusion Assurance Assn, Re*, (1882) 20 Ch D 137; *Greenburg* v *Cooperstein, Re*, [1926] 1 Ch 657. By registration under the Act, the association can rid itself of disabilities. *Thomas Poppleton, Re*, (1884) 14 QBD 379.

12 ILR (1926) 48 All 735.

This opinion was followed in *Kumarswami Chettiar* v *Chinnathambi Chettiar*[13] where the court added that "it is well established that the consequence of the illegality of a partnership is that its members have no remedy against each other for contribution or apportionment in respect of partnership dealings and transactions".

The position was clarified by the Supreme Court in *Badri Prasad* v *Nagarmal*[14]:

> The case arose out of a suit for recovering the contribution made to an illegal association[15] and also for accounts. It was contended that the objects of the association were not illegal and the same, being dissolved, recovery should be allowed in the manner of realisation of the assets of a dissolved firm.
>
> The court held that "such a claim is clearly untenable. The only course for the courts to pursue is to say that he is not entitled to any relief as the courts cannot adjudicate in respect of contracts which the law declares to be illegal."[16]

The partnership analogy was also rejected. "An unregistered firm is not illegal."[17]

Individual members will be entitled to recover their subscriptions and to have the assets realised for this purpose. This would not advance illegality. It would rather terminate an illegal gathering and would also prevent grabbing of assets and subscriptions by the member in whose hands they perchance fall.[18]

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13 [1950] 2 MLJ 453.

14 AIR 1959 SC 559 : (1959) 29 Comp Cas 229.

15 The association was illegal under S. 4(2) of the Rewa State Companies Act, 1935, parallel to the present S. 11.

16 Relying upon *Senaji Kapurchand* v *Pannaji Devichan*, AIR 1930 PC 300.

17 The subscribers of a chit fund do not fall within the section because they do not constitute an association, *G. K. Naidu* v *G. K. Mouleswar*. AIR 1962 AP 406.

18 *Seth Badri Prasad* v *Seth Nagar Mal*. (1959) 29 Comp Cas 229 SC : AIR 1959 SC 559 : 1959 SCJ 394.

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Reconstruction and Amalgamation

Compromises and Arrangements

A "compromise" presupposes the existence of a dispute, for, "there can be no compromise unless there is some dispute".[1]

The dispute may then be resolved by drawing up a scheme of compromise. Even when there is a dispute, but the scheme is such that the members have to give up their rights entirely, it will not be a compromise or arrangement.[2] Surrender of rights without any compensation or any measure of accommodation on both sides cannot be regarded as a compromise. BOWEN LJ observed in a case:[3]

> Everybody will agree that a compromise or arrangement which has to be sanctioned by the court must be reasonable, and that no arrangement or compromise can be said to be reasonable in which you can get nothing and give up everything. A reasonable compromise must be a compromise which can, by reasonable people conversant with the subject, be regarded as beneficial to those on both sides who are making it.... It would be improper for the court to allow an arrangement to be forced on any class of creditors, if the arrangement cannot reasonably be supposed by sensible business people to be for the benefit of that class as such, otherwise the sanction of the court would be a sanction to what would be a scheme of confiscation. The object of this section is not confiscation. It is not that one person should be a victim, and that the rest of the body should feast upon his rights. Its object is to enable compromises to be made which are for the common benefit of the creditors, or a class of creditors as such.

But "arrangement" is a term of wider connotation. A re-arrangement of rights or of liabilities is possible without the existence of any dispute. Thus, where under a scheme each shareholder of a company had to transfer some of his shares to another company and some to its shareholders the court refused to uphold the scheme as there was no dispute which the scheme purported to resolve. But the Court of Appeal held that the word "arrangement" should not be taken to mean the same thing as a compromise.[4]

When a company has a dispute with a member or a class of members or with a creditor or a class of them, a scheme of compromise may be drawn up.

Where there is no dispute but even so there is need for re-adjusting the rights or liabilities of a member or a class of them or of a creditor or a class of them, the company may resort to a scheme of arrangement with them. Section

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1 See *Sneath* v *Valley Gold Ltd*, [1893] 1 Ch 477 : 68 LT 602, where the word "compromise" appearing in a trust deed was given this meaning.

2 *N F U Development Trust, Re*, [1972] 1 WLR 1548.

3 *Alabama, New Orleans, Texas and Pacific Junction Rly Co, Re*, [1891] 1 Ch 213 : 64 LT 127 : 7 TLR 171 : [1886-90] All ER Rep Ext 1143.

4 *Guardian Assurance Co, Re*, [1917] 1 Ch 431 : 116 LT 193. *See* also *Mercantile Investment & General Trust Co* v *International Co of Mexico*, [1893] 1 Ch 484, 491 : 68 LT 603.

390 itself provides that "the expression 'arrangement' includes a reorganization of the share capital of the company by the consolidation of shares of different classes, or by the division of shares into shares of different classes, or by both those methods". The provisions of Sections 391 and 393 show that a compromise or arrangement can be proposed between a company and its creditors or between a company and its members. Such a compromise would also cover any scheme of amalgamation or merger of one company with another.[5]

A company can enter into schemes even where no power has been specifically given by the memorandum of association because Chapter V of the Companies Act gives power to companies to apply for sanction of arrangement, compromise or amalgamation.[6]

Sanction of Tribunal [S. 391]

Earlier to the Second Amendment of 2002, this power was vested in the Court. Now this power has become vested in the Tribunal. The company, or its liquidator (if it is in winding up), or any member or creditor may make an application to the Tribunal. An application can be made only by a member or creditor of the class which is affected by the compromise or arrangement proposed by the company.[7] The company has to place different interests in separate classes. Thus where in a scheme of arrangement, persons with dissimilar interests were put in a single class the court refused to sanction the scheme[8] and said:

> It seems plain that we must give a meaning to the term 'class' as it will prevent the section being so worked as to result in confiscation and injustice and that it must be confined to those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest.

In a case before the Allahabad High Court, *Premier Motors (P) Ltd* v *Ashok Tandon*,[9] a scheme of compromise with the company's depositors placed all the depositors in one class, although the deposits of some of them had, and those of

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5 *Miheer H. Mafatlal* v *Mafatlal Industries Ltd*, (1997) 1 SCC 579 : (1996) 87 Comp Cas 792.

6 *Aimco Pesticides Ltd, In re*, (2001) 103 Comp Cas 463 (Bom).

7 An application was allowed to be made by two persons (one of whom was a managing director) who agreed to provide funds, the court telling the official liquidator of the company to treat them as members for the shares that they had agreed to buy and as creditors in place of those who were going to be paid off with their money. *A. K. Mishra* v *Wearwell Cycle Co (India) Ltd*, (1993) 78 Comp Cas 252 Delhi. The winding up order was cancelled. *Wearwell Cycle Co (India) Ltd* v *A. K. Mishra*, (1994) Comp Cas 219 Delhi. An application by a person who was neither a shareholder nor a member was not allowed. His contention that he was a successor to his deceased mother's shares was also doubtful because he had no good papers with him and he never tried to get the shares transmitted to his name. *N. K. Mohapatra* v *State of Orissa* (1995) 16 Corpt LA 295 : AIR 1994 Ori 301. The court also said that a petition under these sections cannot subsequently be converted into one under Ss. 397 and 398.

8 *Sovereign Life Insurance Co* v *Dodd*, [1892] 2 QB 573 : [1891-94] All ER Rep 246 : 67 LT 396. Members whose shares are paid up in advance constitute a different class from those whose shares are not so paid up. See *United Provident Assurance Co, Re*, [1910] 2 Ch 477 : 103 LT 531.

9 (1971) 41 Comp Cas 656 All.

others had not, matured. M.H. BEG J found nothing wrong with the classification. He said:

> In the case before me, the interests of all the unsecured creditors irrespective of the time when their debts matured, appear to be identical. The company alleges inability to pay any of its unsecured creditors according to contracts of the same kind with identically similar terms.... The interests of every one of the whole of this class of creditors required a consideration of the question whether a scheme for repayment of all debts is not more advantageous to each one of them than to wind up the company. In a winding up, the interests of this whole class would have to be dealt with on the same footing. Hence, their interests are common irrespective of the time when their debts mature for repayment.

All the unsecured creditors do not always constitute a single class. Where fixed deposit holders, lenders of money, holders of hundis and suppliers of material were all herded in a single class without ascertaining what representation of these categories was there at the meeting, it was held that the requirements of the section were not satisfied and that a fresh attempt should be made to reclassify creditors and their consent obtained at separate meetings.[10]

It has been held that a wholly owned subsidiary is also a "class" for the purpose of a scheme of arrangement.[11]

If an application is properly made, the court may order a meeting of the class of creditors or members to be called, which shall be held and conducted in the manner directed by the Tribunal.[12]

A statement of the terms of the compromise or arrangement and its effects has to be sent with every notice calling the meeting. The power of the Tribunal being of judicial nature, it is necessary for its proper exercise that notice should be given to all the interested parties including the shareholders and the Central Government.[13] The role of the Government is that of an

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10 *D. A. Swamy* v *India Meters Ltd*, (1994) 79 Comp Cas 27 Mad. *State Bank of India* v *Alstom Power Boilers Ltd*, (2003) 116 Comp Cas 1 Bom, classification of creditors into unsecured and secured creditors, no further classification necessary. *Wipro Finance Ltd* v *Suman Motels Ltd*, (2002) 108 Comp Cas 549 Bom, a creditor who was entitled only to rental of the machinery supplied on lease was not allowed to be treated as a separate class of creditors.

11 *Hellenic and General Trust Ltd, Re*, [1975] 3 All ER 382: [1976] 1 WLR 123. The Supreme Court held in *Miheer H. Mafatlal* v *Mafatlal Industries Ltd*, (1997) 1 SCC 579: (1996) 87 Comp Cas 792, that where the whole number of equity shareholders were offered a uniform scheme, it was not necessary to sub-divide them into classes and call separate meetings.

12 S. 391(1)(*a*) and (*b*). Where a scheme could not be approved by the members because there was no quorum at the meeting, the court refused to move further. *Suri and Nayar Ltd, Re*, (1983) 54 Comp Cas 868 Kant. Under sub-section (6) the court is empowered to stay the commencement or continuation of any suit or proceeding against the company till the final disposal of the application. In *Arvindbhai V. Patel* v *State of Gujarat*, (1995) 83 Comp Cas 508 Guj, the courts refused to stay prosecution of the manager of the company; he was not a director.

13 *Hind Auto Industries Ltd* v *Premier Motors P Ltd*, AIR 1970 All 165: (1969) 39 Comp Cas 137: [1969] 1 Comp LJ 258. *Maneckchowk & Ahmedabad Mfg Co, Re*, (1970) 40 Comp Cas 819 Guj. Where the requisite meetings of shareholders and creditors was not called and the latest financial position of the company was not laid before the court, sanction to the proposed amalgamation was refused, *Bharat Synthetics Ltd* v *Bank of India*, (1995) 82 Comp Cas 437:

impartial observer. The statement should explain in particular any material interest of the directors, managing director, managing agents, secretaries and treasurers or manager of the company and the effect of the compromise on their interests in so far as that effect is different from the effect on like interests of other persons.[14] "The extent of disclosure required must depend on the nature of the scheme." Thus, where certain information which was exempt from disclosure in the company's accounts was deliberately withheld, the court held that this was not fatal to the arrangement as the proposed compensation was fair and the disclosure of exempt information would have resulted in damage to all the shareholders.[15] But where proper information is not given, the Tribunal will refuse to sanction the scheme even if it has been approved by the requisite majority. Thus:[16]

> A circular sent to debentureholders stated that the scheme has been approved by the trustees, but failed to disclose that the trustees were the company's bankers and therefore interested in the scheme and that the assets had been revalued, but did not give the amount of revaluation, the Court refused to sanction the scheme being based on inadequate disclosures.

If the notice calling the meeting is given by advertisement, the statement should be included in the advertisement or the advertisement should indicate the place at which or the manner in which copies of such a statement may be obtained.[17] When a member or creditor entitled to receive a copy applies for it, the company shall be bound to supply him one free of charge.[18]

Every officer of the company is required to give notice to the company of such matters relating to himself as may be necessary for the purposes of the scheme.[19]

(1995) 17 Corpt LA 152 Bom. An accidental omission or non-delivery of notice, just in the case of an ordinary meeting, would not have the effect of invalidating the meeting. *Maknam Investments Ltd, Re*, (1995) 87 Comp Cas 689 Cal: (1995) 1 Cal HCN 368. It was also held in this case that a person who objects to the scheme would have the right to inspect the company's register of members and also to get copies on payment of fee. The proper procedure of exercising this right would have to be followed.

14 S. 393(1)(*a*). *Gujarat Lease Financing Ltd Re*, (2003) 115 Comp Cas 136 (Guj), an arrangement with debentureholders, notice need not mention bank recovery proceedings or winding up proceedings. Court's sanction would not have affected others. Duties of debenture trustees depend upon provisions of trust deed, adequacy of majority representation depends upon the provision of the company's articles and terms of issue.

15 *National Bank Ltd, Re*, [1966] 1 All ER 1006 Ch D : [1966] 2 Comp LJ 193.

16 *Dorman, Long & Co, Re*, [1934] Ch 635.

17 S. 393(1)(*b*).

18 S. 393(3).

19 S. 393(5). The sub-section imposes a penalty of fine for default in giving the required information. Further, S. 393(4) provides that where a default is made in complying with any of the requirements of the section, every officer who is in default is punishable with fine. The liquidator of the company and trustee for debentureholders are deemed to be officers for this purpose. Criminal proceedings may be commenced or continued, notwithstanding that proceedings have been initiated under S. 390 for sanction of the court. *Uma Investment P Ltd. Re*, (1977) 47 Comp Cas 242 Bom.

If the scheme is approved by a majority representing three-fourths in value of the creditors or members, as the case may be, it may then be sanctioned by the Tribunal.[20] This requirement has been held to be directory, not mandatory. Where a scheme was not approved by the appropriate majority of creditors at their meeting, but subsequently the creditors to the extent of requisite majority filed individual affidavits before the court, that was held to be a sufficient compliance with the statutory requirements.[21]

Duties and Powers of Tribunal

The matters which the Tribunal has to consider in giving its sanction were thus explained by ASTBURY J in *Anglo Continental Supply Co, Re*[22].

> First, that the provisions of the statute have been complied with. Secondly, that the class was fairly represented by those who attended the meeting and that the statutory majority are acting *bona fide* and are not coercing the minority in order to promote interests adverse to those of the class whom they purport to represent; and, thirdly, that the arrangement is such as a man of business would reasonably approve.

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20 Where a composite scheme has been rejected by the secured creditors and approved by the unsecured, it cannot be said to have been approved by the creditors so as to merit the sanction of the court. *Auto Steering India (P) Ltd, Re*, (1977) 47 Comp Cas 257 Delhi. Where a powerful creditor, a public financial institution in this case, refused to approve the scheme and without it the statutory majority was not found, the court can neither approve the scheme nor conduct an inquiry into the motives of the creditor. *M. M. Sehgal* v *Sehgal Papers Ltd*, [1966] 1 Comp LJ 192 P&H. The court cannot accept a scheme when the company is being taken over under the Industries (D&R) Act, 1951. *Gujarat State Textile Corpn* v *N. J. V. Mills Co.* (1985) 58 Comp Cas 768 Guj; *Manekchowk & Ahmedabad Mfg Co, Re*, (1985) 58 Comp Cas 729 Guj. Power of court to substitute the sponsorer. *Bhavnagar Veg Products Ltd, Re*, (1984) 55 Comp Cas 107 Guj. Perfectly reasonable and fair scheme approved by the court in *Mehta Investments (P) Ltd, Re*, [1990] 1 Comp LJ 285 Delhi; *Indo Continental Hotels and Resorts Ltd, Re*, (1990) 69 Comp Cas 93 Raj; *Hotel Pink City (P) Ltd, Re*, (1990) 69 Comp Cas 93 Raj. *Vidiani Engineers Ltd Re*, (2003) 115 Comp Cas 389 All. only 10% of the creditors filed affidavits to approve the scheme, the application of the company for sanction was dismissed. *Motorol India Ltd Re*, (2001) 103 Comp Cas 389 Guj, the court (now Tribunal) refused to entertain an application where the scheme was opposed by a majority of the creditors who sought winding up.

21 *S M Holding & Finance Ltd* v *Mysore Machinery Mfrs Ltd*, (1993) 78 Comp Cas 432 Kant. The approval was expedient also for the reason that it had become necessary to pull the company out of its standstillness in the interest of workers and machinery. Where meetings of creditors and members were not held and the secured creditors of both the companies which were their respective banks objected justifiably that their claims would be prejudiced because liabilities of both companies exceeded their assets, the court refused sanction. *Bharat Synthetics Ltd* v *Bank of India*, (1995) 17 Corpt LA 152 Bom: (1995) 82 Comp Cas 437. An approval by overwhelming majority is a symbol of the soundness of the scheme. The court would not interfere. It cannot substitute with its wisdom the collective wisdom of the shareholders. *Cetex Petrochemicals Ltd, Re*, (1992) 73 Comp Cas 298 Mad. Rejection by a sole secured creditor amounted to rejection by 100% secured creditors, hence no approval. *Komal Plastic Industries* v *Roxy Enterprises P Ltd*, (1991) 72 Comp Cas 61 Del.

22 [1922] 2 Ch 723, 736. *See* also *Bengal Bank* v *Suresh*, AIR 1952 Cal 133. The court can interfere only when the scheme is manifestly unfair or is adopted as a device to defraud some shareholders, *Makhnam Investments P Ltd, Re*, (1996) 87 Comp Cas 689 Cal. Where the scheme was approved by the relevant quarters, objections of persons other than shareholders were ignored, *Malvika Madan Sehgal* v *M.M. Sehgal Ltd*, (1997) 91 Comp Cas 133 Del.

Compliance with statutory provisions.—The first condition enables the court to decline its sanction to a scheme which is *ultra vires* or is otherwise not in compliance with the Act. Thus where a scheme involved reduction of capital, the court refused to uphold it and allowed the application to stand over to enable the company to comply with the normal procedure of capital reduction.[23] But the Tribunal has the power to grant such sanction in the same proceedings. Thus, in *Maneck Chowk and Ahmedabad Manufacturing Co, Re,*[24] the Gujarat High Court accorded a separate sanction for reduction of capital and said:

> Section 391 provides a complete code of putting through a scheme of compromise and arrangement, which may even include reorganisation of share capital subject to the well-recognised exception that if reorganisation includes reduction, the proper procedure for effecting the same may be gone through.

In the opinion of the Calcutta High Court it is not necessary for the validity of a scheme of amalgamation that the company should have an express power of amalgamation in the memorandum. Sections 391-395 confer on every company a statutory power for the purpose.[25]

Bona fide exercise of majority power.—The second condition enables the court to see that the majority power has been exercised in good faith for the benefit of the class as a whole.[26] If it appears to the court that "the majority was composed of persons who had not really the interest of that class at stake", the scheme may not be sanctioned.[27] Thus majority approval obtained by improper inducements will be ineffective.[28] It is not, however, necessary that the meeting

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23 *Cooper, Cooper* v *Johnson, Re,* [1902] WN 199. *See* also *Oceanic Steam Navigation, Re,* [1939] Ch 41. Minor irregularities are, however, ignored. *See* Palmer's COMPANY LAW, 669 (1959).

24 (1970) 40 Comp Cas 819.

25 *Marybong and Kyel Tea Estates Ltd, Re,* (1977) 47 Comp Cas 802 Cal. Formerly by virtue of the provisions against monopolies in the Monopolies and Restrictive Trade Practices Act, 1969 permission of the MRTP Commission had to be taken. These provisions of the MRTP Act have been repealed. Monopolies Commission can now examine only this aspect whether the merger would be anti-competitive or would establish monopolistic trade practices. *Maharashtra General Kamgar Union* v *Hindustan Lever Ltd,* (1994) 81 Comp Cas 784 MRTPC. The fact that the affected company's name would have to be changed was considered to be no obstruction because it could be done even afterwards in view of the provisions of S. 23 to the effect that change of name does not affect the rights and liabilities of the company, *Hipolin Products Ltd, Re,* [1996] 2 Comp LJ 61 Guj; *Novapan India Ltd, Re,* (1997) 88 Comp Cas 596 AP: (1997) 25 Corpt LA 224 AP; *GUK Hotels Ltd, Re,* (1997) 88 Comp Cas 596 AP. It is not necessary that the transferee company should be converted into a public company before sanction because its membership was to increase after the transfer. Such formalities could be observed afterwards also, *Winfiled Agro Services P Ltd, Re,* (1996) 86 Comp Cas 587: AIR 1996 AP 230; *Hindustan Antipests P Ltd, Re,* (1996) 86 Comp Cas 587: AIR 1996 AP 230. Where alteration of objects was necessary, the court could sanction it, *Rangkala Investments Ltd, Re,* (1997) 89 Comp Cas 754 Guj; *Gujarat Organics Ltd,* (1997) 89 Comp Cas 754 Guj. Now the companies have a free hand in alteration of objects by just passing a special resolution.

26 All majority powers are subject to this principle. *See* LINDLEY MR in *Allen* v *Gold Reefs of West Africa,* [1900] 1 Ch 656, 671: [1900-03] All ER Rep 746.

27 BOWEN LJ in *Alabama etc Rly, Re,* [1891] 1 Ch 213, 244.

28 *British America Nickel Corpn* v *O'Brien Ltd,* 1927 AC 369 PC.

should be attended by a majority of the total number of members or creditors. It is enough that the requisite majority is obtained at the meeting.[29]

Reasonableness of scheme.—The last condition enables the court to examine the reasonableness of the scheme. The scheme should be fair and equitable. The approval of the scheme by the statutory majority is a strong evidence of its reasonableness. If the scheme is otherwise fair, the court will not go into its commercial merits.[30] But if the scheme is illusory, the court may refuse its sanction, even if it has been approved by the requisite majority. A scheme of this kind was before the Allahabad High Court in *Premier Motors P Ltd* v *Ashok Tandon*[31]:

> Two companies had taken deposits from the public on 12% interest. Most of the depositors were women and aged, of lower middle classes who had invested their life-long savings to make provision for their dependants. When the deposits began to mature, the depositors were told that the companies were running at a loss, one of them remaining out of business for two years. A scheme was drawn up which envisaged full payment to depositors at less interest but gave no date by which they would be fully re-paid. At a meeting of depositors held under the court's order the scheme was approved by the statutory majority and the company petitioned for the court's sanction.

M. H. BEG J refused to sanction the scheme. The scheme was not only illusory but was also intended to hoodwink the poor depositors. Its aim was to evade contractual obligations as and when they arose. The majority approval was obtained on inadequate information.

> As our law stands today, the initial duty of satisfying the court, that all relevant materials, including the latest financial position of the company and the latest auditors' reports and accounts of the company concerned have been placed before the court so as to enable it to judge where the interests of creditors lie, rests upon the supporters of the scheme. If the court cannot be satisfied that all relevant materials have been placed before the court, it could not be said that such material could be or was actually placed before the unsecured creditors on whose behalf decisions were taken by proxies.... The material placed before the court actually indicates that a winding up in each of the two cases is more advantageous to the creditors than the illusory scheme put forward, only to gain time and to prevent further investigation into the way losses have occurred.

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29 *Bessemer Steel Co, Re*, (1876) 1 Ch D 251.

30 *London Chartered Bank of Australia, Re*, [1893] 3 Ch 540. *See* also MAUGHAM J in *Dorman Long & Co, Re*, 1934 Ch 635, 657. *State Bank of India* v *Alstom Power Boilers Ltd*, (2003) 116 Comp Cas 1 Bom, no interference in commercial wisdom of shareholders and their management.

31 (1971) 41 Comp Cas 656 All.

Burden of proving unfairness.—Once a scheme has been approved of by a class, the burden of proving that it is unfair is on those who oppose it.[32] Where a scheme offered an option to the transferor company's shareholders either to accept shares in the transferee company, or in case of dissent, cash and the cash was less by about 24% than the value of the shares offered, the court held that spot cash, though less, may still be fair, but it should not be less to that extent. Anything between 15 to 20% less would have been fair.[33] A company which was carrying on two separate businesses, namely, tea broking and property dealing, devised a scheme for transferring the property business to a wholly owned subsidiary. The scheme was approved by all the affected quarters, but was opposed by the Company Law Board on several grounds including this that the property was being transferred at a very nominal cost and this involved evasion of capital gains tax, stamp duty *etc*, and that the scheme was also intended to avoid obtaining the sanction of the Urban Land Ceiling Authority which would have been necessary otherwise. The Calcutta High Court held that the company had the legal right to split its undertaking and nobody can be deprived of his legal rights merely because the exercise of it involves certain incidental consequences.[34]

Disclosure of material facts.—The Act now specifically provides that the court shall not sanction any scheme unless it is satisfied that the company or the applicant has disclosed to the court by affidavit or otherwise, all material facts relating to the company, such as its latest financial position, the latest auditors' report, the pendency of any investigation proceedings, *etc*, and the like. Schemes involving cancellation of arrears of accumulated preference dividends,[35] or requiring debentureholders to accept shares in place of debentures,[36] or to accept as their debtor a company to which the assets of their company are transferred, have been approved under the section.[37]

Interest of creditors.—There is nothing in the Act requiring notice of a scheme to be sent to the creditors also. The Delhi High Court has pointed out that this is a lacuna in the Act which should be remedied.[38] But even so there is no special cause of concern because the court can, in the exercise of its discretionary power, refuse to sanction a scheme unless the interest of creditors

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32 *Holders Investment Trust, Re*, [1971] 1 WLR 583: [1971] 2 All ER 289. Technical viability of the scheme is for the companies' experts to consider. *Mafatlal Industries Ltd, Re*, (1995) 17 Corpt LA 249 Guj : (1995) 84 Comp Cas 230.

33 *Dena Bank Ltd, Re*, (1976) 46 Comp Cas 541 Bom. *See* also *United Bank of India* v *United India Credit and Development Co Ltd*, (1977) 47 Comp Cas 689 Cal.

34 *A. W. Figgis & Co P Ltd* ; *Queens' Park Property Co Ltd, Re*, (1980) 50 Comp Cas 95 Cal.

35 *Balmenach Glenlivit Distillery, Re*, [1916] SC 639 Scotland.

36 *Empire Mining Co, Re*, (1890) 44 Ch D 402.

37 *Brown Guild Property Society, Re*, [1898] WN 80. *Creditors of Bedrock Ltd* v *Bedrock Ltd*, (1998) 2 Bom LR 5 Bom, a petition for compromise and arrangement was dismissed because the petitioners had not stated the relevant facts correctly and candidly either in the petition or in the affidavits. That alone showed that the scheme was not bonafide. *Gujarat Kamdar Sahkari Mandli Ltd* v *Ahmedabad Shree Ramkrishna Mills Co Ltd*, (1996) 2 Guj CD 317 Guj, bonafide scheme proposed by workers, ordered to be considered by calling meetings.

38 *Union of India* v *Asia Udyog P Ltd*, (1974) 44 Comp Cas 359 Delhi, and again in *Ansal Properties and Industries Ltd, Re*, (1978) 48 Comp Cas 184 Delhi.

is taken care of. The court may even call a meeting of the creditors for this purpose. In the instant case, however, no such order was considered necessary because it was the creditor company itself which was taking over the debtor company. The court does not have the power to prevent a secured creditor from enforcing his security. The Bombay High Court refused to issue an injunction to prevent a mortgagee from bringing the company's factory to sale or to resort to any legal proceeding for that purpose.[39]

Advantages of Tribunal's Sanction

The Tribunal's sanction is advantageous from several points of view. In the first place the scheme becomes binding upon all the parties to it[40] including the shareholders, the company and creditors.[41] The word 'creditor' includes all kinds of creditors and also the State to which some sales tax is due. If, for example, the scheme envisages the payment of four annas in the rupee "in full and final settlement" of the claim of every unsecured creditor, the State can also recover only 1/4th of the tax due. It cannot proceed to recover the entire amount due even if the final assessment was completed after the scheme was sanctioned.[42]

Firstly, this way the majority of a class of members of creditors can bind the minority. Where one of the merging companies was at Bombay and the other in Gujarat and a director of the transferor company at Bombay did not raise any objection when the Bombay High Court granted its approval, he became bound and was precluded from raising any objection while the transferee company sought the approval of the Gujarat High Court.[43] Secondly, the company is rescued from its financial straits. The trouble and expense of winding up and of forming a new company are saved. Thirdly, the court sanctioning the scheme has the power to supervise its implementation.[44]

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39 *Sakamari Steel & Alloys Ltd, Re*, (1981) 51 Comp Cas 266 Bom. *LG Electronics System India Ltd Re*, (2003) 116 Comp Cas 48 Del, a secured creditor whose entire claim has been paid out, has no right to a notice or to appear before the Tribunal to raise any objections.

40 S. 391(2). See *Punjab National Bank Ltd* v *Shri Vikram Cotton Mills*, (1970) 1 SCC 60: (1970) 40 Comp Cas 927; *Delhi Flour Mills Ltd* v *Indian Hardware Industries*, (1983) 53 Comp Cas 814 Del. A scheme sanctioned by the court became binding on the landlord of the premises of which the company was the lessee. *Ajit Kumar Bose* v *State of WB*, (1998) 20 Corpt LA 222 Cal.

41 But a managing director cannot take the benefit of it. Pending decrees against the company would be superseded, but not the one which was against the company and the managing director jointly. *B. K. Muthukrishna* v *S. Mills Ltd*, (1976) 46 Comp Cas 274 Mad. The effective date of the scheme is the date of the court's order. *CIT* v *Swastik Rubber Products*, (1983) 53 Comp Cas 392 Cal; *Flex Industries Ltd, Re*, [1989] 3 Comp LJ 28 Del; *Mehta Investments P Ltd, Re*, [1990] 1 Comp LJ 285 Del, schemes with all round approval.

42 *Seksaria Cotton Mills Ltd* v *A. E. Naik*, (1967) 37 Comp Cas 656 Bom. The court has the power to stay pending civil and criminal proceedings if that be necessary for implementation of the scheme. *Harish C Raskapoor Jaferbhai Mohamedbhai Chhatpar*, (1989) 65 Comp Cas 163 Guj.

43 *Mafatlal Industries Ltd Re*, (1995) 17 Corpt LA 249 Guj: (1995) 84 Comp Cas 230. The scheme becomes universally binding from its effective date, namely, date of approval of the parties and not that of the sanction of the court. Where a creditor obtained a decree against the company he could not enforce it in the meantime, *Raghubar Dayal* v *Bank of Upper India Ltd*, (1997) 2 SCC 302: AIR 1919 PC 9; approved by the Supreme Court in *Marshall Sons & Co (India) Ltd* v *ITO*, (1997) 88 Comp Cas 528 SC.

44 S. 392(1)(*a*).

An appeal can be preferred against the scheme to the next higher court.[45] The order of the court takes effect when a certified copy has been filed with the Registrar.[46]

Power of enforcement and supervision [S. 392]

The Tribunal which has sanctioned a scheme of compromise or arrangement has the power to supervise the carrying out of the scheme. The Tribunal may introduce any modifications necessary for the proper working of the scheme.[47] The Tribunal can pass an order of modification by itself and need not wait for an application.[48] The Tribunal may order an extraordinary meeting of the shareholders of the company if it is necessary for constituting a new board of directors for revival of the company. The exercise of this power would not be affected by the exclusive power of the Tribunal under S. 186 for calling an extraordinary general meeting. The shareholders did not raise any objections at the meeting. The meeting was held to be valid.[49] Where some members failed to execute instruments of transfer of their shares under the scheme, the court appointed two officers of the transferee company to execute transfers on behalf of the defaulting shareholders.[50] If the court finds that the scheme cannot be worked satisfactorily, it may make an order for compulsory winding up of the company. The court may do so on its own motion or on the application of any person interested in the company's affairs.[51]

"The effect of a scheme between a company and its creditors is that so long as it is carried out by the company by regular payments in terms of the scheme, a creditor who is bound by it cannot maintain a petition for winding up. But if the company commits a default there is a debt presently due and a petition for winding up can be sustained."[52] Thus, for example, in *New Kaiser-i-Hind Spinning and Weaving Co, Re*[53]:

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45 S. 391(7).

46 S. 391(3). A copy of the order is also required to be annexed to every copy of the memorandum issued subsequent to the filing of the copy with the Registrar. S. 391(4). Sub-section (5) is a penalty provision. This power includes the fixing of a time-limit up to which proposals would be received. See *Sidhpur Mills Co Ltd, Re*, (1980) 50 Comp Cas 7 Guj.

47 S. 392(1)(*b*). See *Punjab National Bank Ltd* v *Shri Vikram Cotton Mills*, (1970) 1 SCC 60 : (1970) 40 Comp Cas 927; *Mansukh Lal* v *M. V. Shah, OL*, (1976) 46 Comp Cas 279 Guj.

48 *Ram Lal Anand* v *Bank of Baroda*, (1976) 46 Comp Cas 307 Del; *Ved Mitra* v *Globe Motors Ltd*, (1978) 48 Comp Cas 64 Delhi. The court cannot be called upon to modify a scheme which was never approved by it. *Nathumal Lal Chand* v *Bharat Jute Mills Ltd*, (1983) 53 Comp Cas 382 Cal.

49 *Sreerama Vilas Press and Publications P Ltd, Re*, (1992) 73 Comp Cas 275 Ker; *K. Meenakshi Amma* v *Sreerama Vilas Press and Publications P Ltd*, (1992) 73 Comp Cas 285 Ker. A person who was not able to show himself to be a continuing member of the company was not allowed to raise any objections qua member, *Vayaz Indian Pesticides P Ltd Re*, (1999) 35 CLA 386 Bom.

50 *Bank of Baroda Ltd* v *Mahindra Ugine Steel Co*, (1976) 46 Comp Cas 328 Guj.

51 S. 392(2).

52 *J K (Bombay) P Ltd* v *New Kaiser-i-Hind Spg and Wvg Co*, [1970] 1 Comp LJ 151 SC : AIR 1970 SC 1041 : 40 Comp Cas 689. See also *D. S. Venkataraman* v *Gujarat Industries*, (1977) 47 Comp Cas 352. Where payments were not made in accordance with the terms of the scheme, the court ordered payment of interest for the period of default, *Mysore Electro Chemical Works Ltd* v *G.K. Parmashty*, (1996) 86 Comp Cas 571 Kant.

53 [1968] 2 Comp LJ 225.

A and *B*, two groups of shareholders were contending for the control of a company. They agreed that *A* should transfer the controlling shares to *B* at a nominal value and *B* should provide finance for running the company's mills, and when the company stabilised, to execute a second mortgage in favour of *A* for debts. The scheme was confirmed at shareholders' and creditors' respective meetings and sanctioned by the court. Subsequently *B* failed to provide the necessary finance.

The court held that the inability to provide finance in terms of the scheme and the consequent inability of the company to carry on business at a profit makes the scheme unworkable and, therefore, winding up should follow.

Where a scheme for rehabilitation of a company was formulated by the Government and approved by the Supreme Court but the IDBI was raising objections in releasing funds to promoters, the Supreme Court directed the financial institution to implement the scheme and reminded it of its duty to ensure the economic growth of the country.[54]

Interests of Employees and workers

The Tribunal cannot be called upon to sanction a scheme which is unworkable on the face of it.[55] Where a scheme demanded of the workers to waive their claim to compensation under the Industrial Disputes Act, and also notice money and gratuity, the proposal being unfair, the court refused an order for calling a meeting of the creditors for consideration of the scheme.[56] Where full care was taken of the interest of employees under a commitment by the transferee company that it would honour all the promises of the transferor company to its employees, the court said that the workmen's objections were liable to be overruled.[57] Where, on the other hand, a scheme involved heavy sacrifices on the part of all including workers to restart a textile mill, the scheme was approved by all concerned and the court sanctioned it. It was not considered necessary that the sponsor should disclose the sources of his finance.[58] Kerala High Court approved a scheme proposed by the workers of the company under which they were to take over the management. The members and creditors of the company had agreed to give them a chance.[59]

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54 *Ashok Paper Mills Kamgar Union* v *UOI*, (1997) 10 SCC 113: (1997) 89 Comp Cas 658 SC.

55 As between the workers who prayed that the company should be handed over to them and a cooperative society which also made a similar prayer, the court preferred the former because the cooperative society lacked where-withal and experience. *Rajiv Cotton Traders* v *Official Liquidator*, (1992) 73 Comp Cas 51 Guj.

56 *Krishnakumar Mills Ltd, Re*, (1975) 45 Comp Cas 248 Guj.

57 *Tata Oil Mills Co Ltd & Hindustan Lever Ltd*, (1994) 81 Comp Cas 754 Bom; *Hindustan Lever Employees' Union* v *Hindustan Lever Ltd*, 1995 Supp (1) SCC 499: AIR 1995 SC 470: (1995) 83 Comp Cas 30.

58 *Hathisingh Mfg Co Ltd, Re*, (1976) 46 Comp Cas 59 Guj.

59 *Star Tile Works, Re*, (1980) 50 Comp Cas 286 Ker. The employees may refuse to go to the transferee company, but they cannot stand in the way of the scheme being sanctioned. *Bengal Tea Industries* v *Union of India*, (1988-89) 93 Cal WR 542 and *John Wyeth (India) Ltd, Re*, (1988) 63 Comp Cas 233 Bom. It was also pointed out in the above-mentioned first scheme that as the creditors were given the same protection which they had in their debtor company they should not object. *Regional Fund Commissioner* v *Raj Kumar Nemani*, (1995) 1 Cal LJ 89 Cal: (1995) 16 Corpt LA 405, members of the Committee of

The mere fact that the company has not paid the claim of a former employee is not sufficient to show that the scheme is unworkable.[60]

Reconsideration of sanctioned scheme

The Tribunal has the power to set aside a sanctioned scheme if the Tribunal's sanction was obtained by fraud. But no such drastic step was taken because the scheme had been acted on for over ten years. The beneficiaries of the scheme were given the opportunity to reconsider the applicant's claim.[61] An English Court held that it would not set aside a judgment obtained by fraud if satisfied that the result would have been the same even if the fraud had not been practiced. The order in this case was based on wrong facts but even so it turned out to be the right decision in the light of the true facts.[62] The Supreme Court set aside an approved scheme because legal requirements were not complied with. The sanction of the court (now Tribunal) is not an empty formality and, therefore, the court (now Tribunal) has to observe the proper procedure. In this case the provisions of the Act were not specified under which the scheme was formulated or vacant land of the company was proposed to be sold. Notice to the Central Government was not given, no other publicity was made, latest financial position and chances of revival were not considered.[63]

Reconstruction and amalgamation [S. 394]

Reconstruction.—"There is 'reconstruction' of a company when that company's business and undertaking are transferred to another company formed for that purpose, so that as regards the new company substantially the same business is carried on and the same persons are interested in it as in the case of the old company."[64] A reconstruction may become necessary for several purposes. A court (now Tribunal) may not, for example, sanction a radical change of objects. New objects can then be adopted only by the process of reconstruction.[65] A reconstruction may also become necessary to cause material alterations of the rights of a class of shareholders or creditors.[66]

Management constituted by the court do not become court officers. The anxiety of the court should be to protect workers and not to obstruct development and growth. *Hindustan Lever Employees's Union* v *Hindustan Lever Ltd*, 1995 Supp (1) SCC 499: (1995) 83 Comp Cas 30: AIR 1995 SC 470; *All India Blue Star Employees' Federation* v *Blue Star Ltd*, (2000) 37 CLA 157 Bom; reaffirmed by DB, (2000) 27 SCL 265 Bom DB, the court did not find any prejudice to the rights of workers.

60 *Chaugule* v *New Kaiser-i-Hind Spg and Wvg Co*, [1968] 2 Comp LJ 28 Bom.

61 *Central Bank of India* v *Ambalal Sarabhai Enterprises Ltd*, [1999] 3 Comp LJ 98 Guj.

62 *Fletcher* v *Royal Automobile Club Ltd*, [2000] 1 BCLC 31 CA.

63 *State of WB* v *Sri Pronab Kr Sur*, (2003) 114 Comp Cas 664 SC.

64 J. A. Hornby, AN INTRODUCTION TO COMPANY LAW, 174 (1957).

65 *North of England Protecting & Indemnity Assn, Re*, (1929) 45 TLR 296.

66 See *Bank of India Ltd* v *Ahmedabad Mfg & Calico Printing Co*, (1972) 42 Comp Cas 211 Bom. Where the companies are situated in two different jurisdictions, the sanction of both the courts would be necessary to give to the scheme an all-round binding efficacy. *Industrial Credit & Investment Corpn of India* v *Financial and Management Services Ltd*, AIR 1998 Bom 305. The supervisory jurisdiction of the court was also stressed in this case.

Amalgamation.—"Amalgamation occurs when two or more companies are joined to form a third entity or one is absorbed into or blended with another."[67] The effect is to wipe out the merging companies and to fuse them all into the new one created. The new company comes into existence having all the property, rights and powers and subject to all the duties and obligations, of both the constituent companies. Explaining the object of an amalgamation and the scheme of the statutory provisions, the Madras High Court observed in *W A Beardsell & Co P Ltd, Re*[68]:

> The word 'amalgamation' has not been defined in the Act. The ordinary dictionary meaning of the expression is 'combination'. Judging from the context and from the marginal note of Section 394 which appears in Chapter V relating to arbitration, compromises, arrangements and reconstructions, the primary object of amalgamation of one company with another is to facilitate reconstruction of the amalgamating companies and this is a matter which is entirely left to the body of shareholders, (and) essentially an affair relating to the internal administration of the transferor company. The decision of the body of the shareholders ought not to be lightly interfered with.

Power of amalgamation.—There should be power in the company's memorandum to amalgamate. If it is not there it should be acquired by altering the memorandum.[69] It is not necessary that the company adopting a scheme should be in financial difficulties or that it should not be an affluent company. The expression "any company liable to be wound up under this Act" does not

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67 *Somayajula* v *Hope Prudhomme & Co Ltd*, [1963] 2 Comp LJ 61. It is necessary that the transferee company should be in existence at the "appointed day" though not at the time of the preparation of the scheme. *HCL Ltd, Re*, (1994) 80 Comp Cas 228 Delhi. It is not necessary that both companies should have common objects. *PMP Auto Industries Ltd, Re*, (1994) 80 Comp Cas 289 Bom. The court can authorise necessary alterations in the memorandum after inviting the CLB to state its objections, if any. *Rangkala Investments Ltd, Re*, (1995) 16 Corpt LA 280 Guj ; *Gujarat Organics Ltd, Re*, (1995) 16 Corpt LA 280 Guj.

68 (1968) 38 Comp Cas 197, 204 Mad. See also *Reliance Jute Industries Ltd, Re*, (1983) 53 Comp Cas 591 Cal, where a holding company absorbed its subsidiary and objections under S. 372 [now S. 372-A] were not sustained. The transferor company which is going to be amalgamated can be a foreign company. *Bombay Gas Co* v *Central Govt*, (1997) 89 Comp Cas 195 Bom. The court followed the decision to the same effect in *Khandelwal Udyog Ltd & ACME Mfg Ltd, Re*, (1977) 47 Comp Cas 503, 511.

69 *Hari Krishna Lohia* v *Hoolungooree Tea Co*, (1970) 40 Comp Cas 458, 463 Cal. A separate petition to CLB for alteration of memorandum is not necessary. The CLB (now Tribunal) can be invited to express its objections in the same petition so that a single window clearance can be provided for all matters. *PMP Auto Industries Ltd, Re*, (1994) 80 Comp Cas 289 Bom. According to S. 376 conditions prohibiting reconstruction or amalgamation are void. The section is as follows:

> "S. 376. *Conditions prohibiting reconstruction or amalgamation of company.*—Where any provision in the memorandum or articles of a company, or in any resolution passed in general meeting by, or by the Board of directors of the company, or in an agreement between the company and any other person, whether made before or after the commencement of this Act, prohibits the reconstruction of the company or its amalgamation with any body corporate or bodies corporate, either absolutely or except on the condition that the managing director or manager of the company is appointed or reappointed as managing director or manager of the reconstructed company or of the body resulting from amalgamation, as the case may be, shall become void with effect from the commencement of this Act, or be void, as the case may be.".

mean a company which is insolvent, but any company registered under the Act, every such company being subject to the winding up provisions of the Act.[70]

Forms of reconstruction and amalgamation.—A reconstruction or amalgamation may take any of the following forms:

1. By sale of shares.[71]
2. By sale of undertaking.
3. By sale and dissolution.[72]
4. By a scheme of arrangement.[73]

Sale of shares is the simplest process of amalgamation or takeover. Shares are sold and registered in the name of the purchasing company. The selling shareholders receive either compensation or shares in the acquiring company. If nine-tenths of the holders of a class have approved the terms, shares of the rest can be acquired under Section 395.

The second method involves a sale of the whole of the undertaking of the transferor company as a going concern.[74]

Section 394 applies to every scheme which involves transfer of the whole or any part of the undertaking or liability of a company to another company.[75] Section 391, therefore, applies and an application may be made to the court by any person entitled to move the court under that section. The court may sanction the scheme and make necessary orders.[76] Such an order may make provisions for any of the following matters:[77]

(*i*) transfer of the undertaking, property, liabilities of one company to the other;

(*ii*) the allotment or appropriation by the transferee company of any shares, debentures, or other like interests which have to be allotted or appropriated under the contract;

(*iii*) the continuation by or against the transferee company of any legal

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70 *Khandelwal Udyog Ltd & ACME Mfg Co Ltd, Re*, (1977) 47 Comp Cas 503 Bom.

71 Allotment of shares on preferential basis to the holding company of the transferee company so as to maintain the majority stake was held to be a fair basis of allotment of shares in the transferee company to the members of the transferor company. *Hindustan Lever Ltd, Re ; Tata Oil Mills Co Ltd, Re*, (1994) 81 Comp Cas 754 Bom.

72 This is considered in connection with voluntary winding up.

73 This has already been considered.

74 Amalgamation by outright purchase of the transferor company by the transferee company is recognised by the Accounting Standards of the Institute of Chartered Accountants. A petition is maintainable for the approval of such a scheme. *SPS Pharma Ltd, Re*, (1997) 88 Comp Cas 774 AP; *Targof Pure Drugs Ltd, Re*, (1997) 88 Comp Cas 774 AP.

75 S. 394(1)(*a*) and (*b*). Amalgamation of a company dealing in shares with a transport company, there is no power to prevent it, *Eita India Ltd, Re*, (1997) 24 Corpt LA 37 Cal.

76 The court can examine the bonafides of the person making an objection. Very unusually, the court permitted a transfer of shares which had already been registered to be questioned when it was shown that the shareholder was given that position only for the purpose of using him to raise objections. *Piccadilly Radio plc, Re*, 1989 BCLC 683 Ch D. *New Vision Laser Centres (Raj Kot) P Ltd Re*, (2002) 111 Comp Cas 756 Guj, merger of holding and subsidiary allowed. Powers under S. 391 not subordinate to Sections 42 and 77.

77 S. 394(1)(*a*) and (*b*). *Grierson Oldham & Adams Ltd, Re*, [1967] 1 WLR 385: [1968] Ch 17: [1967] 1 All ER 192.

proceeding pending by or against the transferor company;

(*iv*) the dissolution, without winding up, of the transferor company;

(*v*) the provision to be made for any person who dissents from the scheme;

(*vi*) such incidental, consequential and supplemental matters as are necessary to secure that the reconstruction or amalgamation is fully and effectively carried out.[78]

The order of the Tribunal can provide for matters like violation of Section 42 (subsidiary buying the shares of its holding) or Section 77 (a company buying its own shares) if such processes are involved in the scheme. The Tribunal can also order dissolution without winding up of the transferor company.[79] Section 394 confers wide powers on the Tribunal to be exercised for such purposes so that there are no obstructions to the implementation of a scheme.[80]

Every company in relation to which the order is made has to file within thirty days a copy of the order with the Registrar for registration.[81]

Official reports.—An amendment introduced in 1965 provides that a compromise or arrangement in connection with the amalgamation of a company in winding up with any other company or companies shall not be sanctioned unless the court has received a report from the Tribunal or Registrar that the affairs of the company have not been conducted in a manner prejudicial to the interest of the members or to public interest. Similarly, an order for the dissolution of the transferor company shall not be made unless the official liquidator makes a report that its affairs have not been conducted in a manner prejudicial to the interest of members or to public interest.[82] The Gujarat High Court found in a case[83] that the only purpose for which the transferor company was created was to facilitate the transfer of a building to the transferee company without attracting the capital gains tax and the dissolution of the transferor company was sought without winding up. The court refused to sanction the scheme. In another case where a similar report was submitted by the official liquidator, the court sanctioned the scheme but issued directions which formed part of the scheme which were that instruments of conveyance with payment of stamp duty must be executed, that unassignable rights would not be available to the assignee company, that the sanction would not excuse payment of overdue taxes and that the directors

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78 S. 394(1).

79 *C I T* v *Dalmia Magnesite Corpn*, (1999) 96 Comp Cas 792 SC.

80 *Himachal Telematics Ltd* v *Himachal Futuristic Communications Ltd*, (1996) 86 Comp Cas 325 Del. *Walves Flour Mills Co P Ltd, Re*, (1996) 23 Corpt LA 104 Bom, the court at the registered office of the company would not refuse sanction of amalgamation with a Bombay company when the court at Bombay has granted sanction. *State Bank of India* v *Alstom Power Boilers Ltd*, (2003) 116 Comp Cas 1, when a sick industrial company comes out of sickness and there is a BIFR declaration to that effect, a scheme proposed thereafter does not require sanction of the BIFR.

81 S. 394(3). The sub-section imposes penalty for default.

82 Proviso to S. 395(1) *added* by the Companies Amendment Act, 1965.

83 *Wood Polymer Ltd, Re*, (1977) 47 Comp Cas 597.

would not be absolved from their liability for violations of law, if any.[84] The official liquidator cannot question or object to the share exchange ratio. That is not the function of the official report.[85]

The power of the Tribunal is discretionary. It has been expressly authorised to pay full attention to public interest. The expression "public interest", the court said, "takes its colour from the context in which it is used and will depend upon the object which the legislation wants to promote or the mischief which it seeks to suppress."[86] The philosophy behind taxes being to promote public interests, it cannot be said that a scheme which is designed to avoid taxes is not prejudicial to public interest.[87] The report of the official liquidator is necessary only when the Tribunal has to pass an order of dissolution. Amalgamation does not necessarily involve dissolution of the transferor company.[88] In other cases a report of the Registrar is sufficient.[89]

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84 *Kriti Plastics P Ltd, Re*, (1993) 78 Comp Cas 138 MP.

85 *Nav Chrome Ltd, Re*, (1997) 89 Comp Cas 285 AP; *Nava Bharat Ferro Alloys Ltd, Re*, (1997) 89 Comp Cas 285 AP. It was also held in this case that where in spite of wide publicity, no creditor objected, subsequent objections were not to be entertained. Even otherwise the creditors were getting a financially stronger company as their debtor.

86 The court cited *State of Bihar* v *Maharajadhiraja*, 1952 SCR 889, 994: AIR 1952 SC 252. *Bengal Tea Industries* v *Union of India*, (1988-89) 93 Cal WR 542. *Navyug Investments Ltd, Re*, [1993] 3 Comp LJ 305 Del, merger of six sister companies carrying on the same business and operating from the same place.

87 Where an amalgamation was in the interest of the company as also of its creditors, the report of the official liquidator that the transferee company's tax liability was going to be reduced was ignored. Such matters are not within the function of the official liquidator's report. *Shankar Narayana Hotels P Ltd* v *Official Liquidator*, (1992) 74 Comp Cas 290 Kant. A scheme was not permitted to be revised twelve years after the original order of merger just only because at that time no provision had been made for payment of taxes. *Union of India* v *Asia Udyog P Ltd*, (1993) 78 Comp Cas 468 Delhi. The transferor company would cease to be a tax payer only when it ceases to exist. *Marshall Sons & Co (India) Ltd* v *ITO*, (1992) 74 Comp Cas 236 : [1991] 3 Comp LJ 117 Mad. The company ceases to exist from the date the scheme is sanctioned by the court or such other date as may be specified in the order, *Marshall Sons & Co (India) Ltd* v *ITO*, (1997) 2 SCC 302: (1997) 88 Comp Cas 528 SC. The Supreme Court held that an Income tax notice sent to the company after that date was not legally warranted.

88 *Mathew Philip* v *Malayalam Plantation (India) Ltd*, (1994) 81 Comp Cas 38 Ker FB, not approving on this point, *Official Liquidator* v *Madura Co P Ltd*, 1975 Ker LT 562 and citing *Malayalam Plantation India Ltd* v *Harisons and Crossfield (India) Ltd*, [1985] 2 Comp LJ 409 Ker, an example of amalgamation without dissolution; *General Radio and Appliances Co Ltd* v *M. A. Khader*, (1986) 2 SCC 656: [1986] 2 Comp LJ 249 SC: (1986) 60 Comp Cas 1013 and *Saraswati Industrial Syndicate Ltd* v *CIT*, 1990 Supp SCC 657: AIR 1991 SC 70, explaining the effect of amalgamation in general terms. But see *Webb's Farm Mechanisations P Ltd* v *Official Liquidator*, (1996) 85 Comp Cas 146: AIR 1996 Kant 65, where it was held that an amalgamation being not possible without the dissolution of the transferor company, the report of the official liquidator becomes necessary in all cases.

89 *Marybong and Kyel Tea Estate Ltd, Re*, (1977) 47 Comp Cas 802 Cal. There is no requirement that Income tax office should be notified. In this case there was not even a suggestion that the scheme was intended for tax evasion, *Anand Crown and Seal P Ltd, Re*, (1996) 87 Comp Cas 266 AP. The loss of company's paid up capital and accumulation of liabilities four times to the remaining capital does not prevent amalgamation of such a company with a sound and healthy company. Public interest was also not compromised because the company took over all obligations, *Shree Sai Baba Castings P Ltd*, (1997) 27 Corpt LA 72 Bom.

Where the latest auditors' report is necessary for working out the exchange ratio, it would be the report which is available at the time of the application, namely report on the preceding year's accounts.[90]

Notice to Central Government: Fairness of Exchange Ratio [S. 394]

The Tribunal has also to give notice of every application to the Central Government and has to take into account the representation, if any, made by the Government before sanctioning the scheme.[91] The extent to which the Central Government can intervene was explained by the Calcutta High Court in *Associated Hotels of India Ltd, Re*[92]:

> A merger of three hotels was approved by overwhelming majority of creditors and shareholders of all the companies and, it was accordingly sanctioned by the court. But the Central Government raised the objection that the mode of valuation of assets was not fair and prayed for appointment of independent valuers.

It was held that there cannot be any interference in the valuation made by experts unless there has been a mistake which defeats justice. For example, if the court finds that the appreciated value of the landed property of one of the companies or loans made by it to its directors have not been taken into account, it will be reluctant to grant its sanction.

In *Cotton Agents* v *Vijay Laxmi Trading Co*[93] the court held that the Central Government cannot interfere in the matter of valuation unless there is allegation of fraud or undue influence or that the books of account are unreliable or that different or discriminatory methods of valuation have been adopted.

In another case,[94] the Central Government raised the objection that the shareholders of the transferor company were to get two shares in the transferee company for every five shares and that this was not reasonable and fair to the shareholders of the transferor company. The court overruled this objection. Two respectable firms of chartered accountants had stated that they had examined the accounts, annual reports, working and financial position of the two companies and also considered the net intrinsic value and came to the

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90 *All India Blue Star Employees' Fedn* v *Blue Star Ltd*, (2000) 27 SCL 265 Bom.

91 S. 394-A. *Jindal India Ltd, Re*, (1993) 76 Comp Cas 443 Del.

92 [1968] 2 Comp LJ 292 Cal. Where the exchange ratio was fixed on the basis of the break-up value as recommended by two independent experts, the court considered the ratio to be a fair one though the report of one of them was sketchy and not based upon proper evaluation, that of the other expert was a well considered report, *Mafatlal Industries Ltd, Re*, (1995) 17 Corpt LA 249 Guj: (1995) 84 Comp Cas 230.

93 [1968] 2 Comp LJ 7 Raj. *See* also *Shahibag Enterpreneurs P Ltd, Re*, (1976) 46 Comp Cas 642 Guj. *Hindustan Investments Ltd, Re*, (1988) 64 Comp Cas 116 P&H, Regional Director's objection as to exchange ratio overruled. Valuation on the basis of net value of the company's assets and fixation of exchange ratio was held to be fair and not to be interfered on the objections of the Registrar. *Sanghi Industries Ltd, Re*, (1993) 3 Andh LT 719. Objections against exchange ratio worked out by Chartered Accountants not allowed, *Maknam Investments Ltd, Re*, (1995) 87 Comp Cas 689 Cal: (1995) 1 Cal HCN 368. In an amalgamation of two closely-held private companies, the Central Government's objection as to exchange ratio and small capital base of one of them was overruled, *Mahavir Weaves P Ltd, Re*, (1995) 83 Comp Cas 180 Guj: (1997) 24 Corpt LA 11 Guj.

94 *M G Investment & Industrial Co Ltd* v *New Shorrock Spg & Mfg Co Ltd*, (1912) 42 Comp Cas 145.

conclusion that the ratio of 5:2 was fair and reasonable. The court drew further support from the fact that the scheme of amalgamation had been widely advertised and unanimously approved by the meetings of the shareholders of the two companies and no objection at all had been raised by any of the shareholders or creditors.[95] Calculation of share value by taking net asset value (NAV) on the basis of book value can be accepted as a proper mode of valuation.[96] The date of valuation should be proximate to the date of petition. No balance-sheet was in existence as of that date. The earlier balance-sheet nearest to the date of petition should be taken into account.[97]

In another case, the exchange ratio was worked out by independent auditors, who had followed the proper methods and considered all the financial aspects. The calculation could not be questioned only because one of the auditors was the statutory auditor of the transferee company.[98] Where the share-exchange

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95 Non-disclosure of the valuation report is not sufficient to prevent sanction. S. 393(1)(*a*) does not require all the material facts to be disclosed. *Khandelwal Udyog Ltd & ACME Mfg Co Ltd, Re*, (1977) 47 Comp Cas 503 Bom. Thus the trend of judicial opinion is to attach great weight to the approval by shareholders. Proceeding on this philosophy the Bombay High Court sanctioned a scheme despite the objection from the Government quarters that the quoted company, which was taking over an unquoted company had not made proper valuation of the shares of the latter company. See *Piramal Spinning & Weaving Mills Ltd, Re*, (1980) 50 Comp Cas 514 Bom. The Madras and AP High Courts followed the same principle in *Coimbatore Cotton Mills Ltd & Lakshmi Cotton Mills Co Ltd, Re*, (1980) 50 Comp Cas 623 Mad; *Vijaya Durga Cotton Trading Ltd, Re*, (1980) 50 Comp Cas 785 AP; *Vasant Investment Corpn* v *OL, Colaba Land etc.*, (1981) 51 Comp Cas 20, Bom, winding up stayed on sanctioning a scheme; *Indian Hardware Industries Ltd* v *S. K. Gupta*, (1981) 51 Comp Cas 51 Delhi, power to call meetings; *Mehtab Chand Golcha* v *OL*, (1981) 51 Comp Cas 103 Raj, power to make modifications for adjustment of tax claims. *Tata Oil Mills Co Ltd, Re*, (1994) 81 Comp Cas 754 Bom ; *Hindustan Lever Ltd, Re*, (1994) 81 Comp Cas 754 Bom, fixing the value of an asset by another group company was held to be not proper. Apart from this the valuation rate of share exchange ratio was found to be proper: *Hindustan Lever Employees' Union* v *Hindustan Lever Ltd*, 1995 Supp (1) SCC 499: AIR 1995 SC 470: (1995) 83 Comp Cas 30, approval of valuation by more than 95% of shareholders was not to be interfered with. The court has jurisdiction to stay recovery of taxes. See *Byford Ltd* v *STO*, (1981) 51 Comp Cas 561 Delhi. Valuation of shares done by respectable firms of chartered accountants on the well-known methods of valuation was presumed to be fair, *Sumitra Pharmaceuticals and Chemicals Ltd, Re*, (1997) 88 Comp Cas 619 AP; *Miheer H. Mafatlal* v *Mafatlal Industries Ltd*, (1997) 1 SCC 579: (1996) 87 Comp Cas 792. Where the ratio was worked out by taking into account the rise in the value of assets and there were no allegations of fraud or *mala fides* against the valuer, the exchange ratio was held to be fair and reasonable. High valuation of the transferor company's assets for alleged purpose of piloting the public issue of the newly formed private company, was held not to be a manipulation of share prices at that stage, *APCO Electricals P Ltd, Re*, (1996) 86 Comp Cas 457 Guj. Private companies, intermingled affairs, share exchange ratio seemed reasonable and also approved by shareholders, *Mahavir Weaves P Ltd*, (1997) 24 Corpt LA 11 Guj. Valuation on net asset value basis accepted by both companies and their unanimous shareholders, valuation beyond question, *Jindal India Ltd* v *Cold Rollings India P Ltd*, (1998) 28 Corpt LA 255 Del. *Aradhana Beverages & Foods Co Ltd, Re*, (1998) 74 Delhi LT 276, share exchange ratio by experts, shareholders satisfied, no interference at the instance of Regional Director. *M M Sehgal Ltd* v *Sanmati Trading Investments Ltd*, (1997) 65 Delhi LT 53, frivolous objections by applicants who were not members, rejected, scheme approved.

96 *KMA Ltd* v *Union of India*, (1996) 86 Comp Cas 728: [1997] 1 Comp LJ 343 Delhi.

97 *Nikhil Rubbers P Ltd, Re*, (2002) 108 Comp Cas 438 CLB.

98 *Asian Coffee Ltd, Re*, [2000] CLC 17 affirmed in *Vadalamuddi Rama Rao* v *Asian Coffee Ltd*, [2000] 3 Comp LJ 110 at 119. *Shiva Texyarn Ltd* v *Annamallai Finance Ltd*, (2003) 114 Comp Cas 55 Mad, the scheme provided for issue of shares at a premium, valuation approved by experts and by requisite majority of shareholders. The scheme was sanctioned.

ratio was approved by the requisite majority and no defect was pointed and it was worked out by three chartered accountants by adopting the three applicable methods, the court also approved it. The value of the shares of the transferee company was higher than that of the transferor company's shares. The transferee company also had a good market potential. The court refused to regard the scheme as unfair only because there was a fear in the minds of some shareholders that there would be a big reduction in dividend income.[1]

Where share-exchange ratio was found by the valuers to be fair and equitable and the shareholders of the transferor company also approved the scheme, it was held that the objecting shareholder could not seek direction to the company to provide details of calculation of the ratio.[2]

Notice to the Central Government has to be given at the stage of sanction and not at the stage of application for a direction for calling of a meeting.[3] Notice to the Central Government, having been once given at the stage of sanction, is not required to be given at any subsequent stages, like the stage for an order of the dissolution of the transferor company.[4]

Some instances

Where at a meeting called by the court a scheme of amalgamation was approved by 648 shareholders holding 84,753 shares as against 11 shareholders holding only 48 shares and the dissenting shareholders did not at all appear at the hearing to present their objections, if any, the court accordingly observed:[5]

> If the opposition was legitimate and founded on some material ground, the court would have examined the scheme critically. After examining the scheme from the point of the petitioner, that is, the transferee company, it must be said, without the least fear of being contradicted, that the scheme of

1 *American Remedies Ltd Re*, (2003) 113 Comp Cas 114 Mad.

2 *Challa Rajendra Prasad* v *Asian Coffee Ltd*, (2001) 103 Comp Cas 17 AP. *Alfa Quartz Ltd* v *Cymex Time Ltd*, (2001) 104 Comp Cas 71 Guj, approval by both the transferor and transferee company, the court (now Tribunal) could not be called upon to say that the exchange ratio was prejudicial to their interests. *Gujarat Ambuja Cotspin Ltd Re*, (2001) 104 Comp Cas 397 Guj, valuation done by experts was not interfered with. *Blue Star Ltd, Re*, (2001) 104 Comp Cas 371; exchange ratio worked out by recognised firm of chartered accountants and assets were valued by a Government approved valuer, objection by Regional Director of Company Affairs was not accepted, *H.K. Dave P Ltd, In re*, (2001) 104 Comp Cas 550 (Guj). *Covelong Beach Hotels (India) Ltd, Re*, (2002) 112 Comp Cas 17 Mad, objection and amendment proposed by a shareholder defeated at the meeting, not material, inspection of accounts by ROC also not relevant to the scheme. *Alstom Power Boilers Ltd* v *SBI*, (2002) 112 Comp Cas 674 Bom, the court (now Tribunal) did not question the commercial wisdom of shareholders, objectors who did not attend meetings not entitled to raise objections before the court. Objections to classification should have been made after notice of meeting.

3 *YLM Holdings P Ltd Re*, (2001) 105 Comp Cas 249 Del.

4 *Vikram Organics P Ltd* v *Anirox Pigments Ltd*, (1997) 88 Comp Cas 804: [1997] 3 Comp LJ 193 Cal.

5 *Ahmedabad Mfg & Calico Printing Co* v *Bank of India*, (1972) 42 Comp Cas 493 Guj. A lone shareholder holding microscopic minority interest objected to amalgamation, ruled out; an accidental omission to give him notice of the meeting was also not fatal, *Maknam Investment Ltd*, (1995) 1 Cal HCN 368.

amalgamation, by which a huge sum of Rs 14.70 crores with its accumulated interest would be available to the petitioner both for its expansion as well as for its liquid finances, would undoubtedly be a scheme which is such as a man of business applying his commercial judgment, from his own narrow personal angle, would approve.

In another case[6] arising out of the same facts, the Bombay High Court restated the distinction between "compromise" and "arrangement". The court came to the conclusion that if a scheme of amalgamation involves variation of members' rights that amounts to reorganisation of capital making the sanction of the court necessary and where shares of a different nature, such as bonds convertible into shares, are proposed to be issued that is definitely a reorganisation.

Where a scheme of amalgamation was approved by all the members of the transferee company but no formal meeting was held, the court said that all that was necessary was that the sanction should be put off till a meeting was held and the fact reported to the court.[7]

Vesting of rights and transfer of obligations

All the rights and obligations of the amalgamated company become vested in the amalgamating company.[8] A company taking over another was allowed to continue eviction proceedings. A formal transfer or substitution was not necessary. Where the transfer of property takes place in terms of an order under Section 394, the right to continue the proceedings arises automatically. Where the whole undertaking is taken over, all the rights pass whether mentioned in a schedule or not.[9] The company which emerges from the amalgamation becomes the new tenant because the property rights which pass to the transferee company include tenancy rights also.[10] The supplier of electricity has to take the emerging

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6 *Bank of India Ltd* v *Ahmedabad Mfg & Calico Printing Co*, (1972) 42 Comp Cas 211 Bom. In *Gwalior Strips Ltd, Re*, [1993] 2 Comp LJ 377 and *Spring Steels Ltd, Re*, [1993] 2 Comp LJ 377 MP, the court ignored the objection of the Central Government that the liability of transferor company for violation of the Companies Act was going to be wiped only. The alleged liability was for breaches of Ss. 67 and 68.

7 *Union Services P Ltd, Re*, (1975) 45 Comp Cas 146 Mad. Sanction of a scheme enjoying all round approval, *Hindustan Coca Cola Bottling S W P Ltd Re*, [1999] 4 Comp LJ 442 Delhi. Amalgamation of two cement companies under a scheme which appeared to be just, fair and reasonable from the point of view of a prudent man of business, sanction granted, *Rassi Cement Ltd Re*, (1999) 98 Comp Cas 835 AP.

8 See *Nilinta Chemicals Ltd, Re*, (1997) 26 Corpt LA 347 MP, the court order provided that there would be no prejudice to the tax liability for capital gains and directors' liability for anything wrong and to the need for executing formal documents wherever necessary. *United Breweries Ltd* v *Commissioner of Excise*, (2001) 105 Comp Cas 71 Bom, the shareholders of both the companies being the same, it did not mean that there was no transfer of ownership after amalgamation.

9 *L. Mullick & Co* v *Benani Properties P Ltd*, (1983) 53 Comp Cas 693 Cal.

10 *Telesound (India) Ltd, Re*, (1983) 53 Comp Cas 926 Delhi. Where, however, care was not taken to comply with the State Rent Act and terms and conditions of the rent agreement were not maintained, the transfer of tenancy was ineffective. *General Radio and Appliances Co Ltd* v *M. A. Khader*, (1986) 2 SCC 656: [1986] 2 Comp LJ 249 SC : (1986) 60 Comp Cas 1013. The shareholders of one company cannot restrain another company from adopting a resolution for taking over the company. *Centron Industrial Alliances Ltd* v *Pravin Kantilal Vakil*, (1985)

company as its consumer and cannot say that there has been a transfer of the connection.[11] Where the premises held by the transferor company on lease and licence were found to be not transferable and were, therefore not included in valuation, a failure to mention them in the particulars of the scheme was not fatal to the scheme.[12] Where the circumstances were such that the scheme of revival could not be implemented unless the tenants on the company's premises were evicted, the court passed necessary orders for the purpose.[13]

The vesting takes place from the effective date of the scheme which is either specified in the order of sanction or it is the date of approval of the scheme.[14]

Reduction of Capital in Amalgamation.—Where a scheme of amalgamation involves the merger of two companies into a new company, and the merging companies are to be dissolved without winding up, the fact that the preference shareholders of the merging companies are to be paid back under the scheme does not amount to reduction of capital. This has been so held by the Madras High Court in *T. Durairajan* v *Waterfall Estates Ltd.*[15] The court pointed out "that the scheme of Sections 101 and 102 of the Companies Act clearly envisages reduction in capital in the context of an existing or continuing company, whereas in the present case, both companies had to go out of existence". The court further pointed out that the object of requiring sanction of the court for reduction of capital is to safeguard the interest of the creditors of the company. In the present case the new company had undertaken to pay all the debts of the merging companies and, therefore, the procedure for reduction of capital as laid down in Sections 100, 101 and 102 was not applicable.[16]

Increase of authorised share capital.—Where the scheme of amalgamation involved an increase of the authorised capital of the transferee company, the court said that the procedure prescribed for such increase would have to be observed without any exemption in this respect. The transferee company was bound to carry out the requirements of the scheme.[17]

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57 Comp Cas 12 Bom. Where the scheme did not involve diminution of liability in respect of unpaid share capital, the procedure for reduction of capital had not to be followed. *HCL Ltd, Re*, (1994) 80 Comp Cas 228 Delhi.

11 *Gujarat Ambuja Exports Ltd* v *Gujarat Electricity Board*, (2002) 112 Comp Cas 188 Guj.

12 *Tata Oil Mills Co Ltd & Hindustan Lever Ltd, Re*, (1994) 81 Comp Cas 754 Bom. The court also said that since TOMCO was to be dissolved and it was a part of the Tata group, its trademarks which belonged to the group, would have to be given up by the transferee company by absorbing the products into its own marks system.

13 *Hotel Kandath International P Ltd* v *Official Liquidator*, (1997) 27 Corpt LA 224 Kant.

14 *Bombay Gas Co* v *Central Govt.* (1997) 89 Comp Cas 195 Bom. *Gemini Silk Ltd* v *Gemini Overseas Ltd*, (2003) 114 Comp Cas 92 Cal, transfer of assets and liabilities in terms of the order is a conveyance in consideration of allotment of shares, liable to stamp duty except to the extent of exemption, if any.

15 (1972) 42 Comp Cas 563 Mad. The court can sanction reduction of capital also if there is a substantial compliance with the requirements of reduction, *Novapan India Ltd, Re*, (1997) 88 Comp Cas 596 AP: (1997) 25 Corpt LA 224 AP.

16 See also *Rassi Cement Ltd Re*, (1999) 98 Comp Cas 835, scheme involving reduction of capital approved, confirming the resolution for reduction.

17 *Anmol Trading Co Ltd* v *Shaily Engg Plastics Ltd*, (2003) 113 Comp Cas 107 Bom.

Change of name.—There is no automatic change of name of the company involved in an amalgamation. Proceedings for change of name would have to be followed. A term in the scheme providing for change of name on the sanction of amalgamation was ordered to be deleted.[18]

Amalgamation of banking companies

Section 44-A of the Banking Regulation Act, 1949 is a complete, self-contained code on amalgamation of banking companies. Under S. 44-A, the power to grant approval to the scheme of merger of banking companies is with the Reserve Bank of India (instead of Tribunal) and the RBI is also empowered to determine market-value of shares of the objecting shareholder who voted against the scheme as well as to direct payment of the value of the shares to the dissenting shareholder.[19]

Demerger

A scheme of sub-division of an enterprise into smaller units or splitting up the unit into more than one parts or separating one or more units from the main enterprise and constituting them into separate units is called demerger. Some of the shareholders would be allotted shares in the demerged unit in exchange of their holding in the original unit. Fair exchange ratio becomes necessary in such schemes also. Same considerations apply as in the case of mergers.[20]

Take-over and Acquisition of Minority Interest [S. 395]

If any of the above schemes involves acquisition of the shares of one company by another company, it may do so by making an offer to the transferor company, so that the scheme or contract may be placed before the shareholders of the company.[21] The shareholders have the option to approve the offer within four months. Approval must be accorded by at least nine-tenths in value of the shares whose transfer is involved. This number must be exclusive of any shares already held by the transferee company or by its nominees or by its subsidiary. Once the approval by nine-tenth majority is accorded, the transferee company gets the right to acquire the shares of the dissenting shareholders, if any. Within two months, after the expiry of the above four months, the transferee company should give a notice to such shareholders that it desires to acquire their shares. Within one month from the date of the notice, the dissenting shareholders may apply to the Tribunal. But if no application is made, the transferee company gets the final right and also becomes bound to acquire those shares on the terms on which the shares of other shareholders are to be transferred.

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18 *Govind Rubber Ltd, Re*, (1995) 83 Comp Cas 556 ; *Pavan Tyres Ltd, Re*, (1995) 83 Comp Cas 536 Bom.

19 *Bank of Madura Shareholders Welfare Association* v *Governor, Reserve Bank of India*, (2001) 105 Comp Cas 663 Mad.

20 *Alembic Ltd* v *Dipak Kumar J Shah*, (2002) 112 Comp Cas 64 Guj.

21 S. 395(1). See *Bihari Mills Ltd, Re*, (1985) 58 Comp Cas 6 Guj.

Fairness of Takeover Bids

Section 395 confers a very wide discretion on the Tribunal to sanction or disallow the attempt to acquire.[22] The two guiding principles are that the scheme should be fair and that onus lies to show its unfairness upon the dissenter.[23] The Tribunal will infer fairness from the very fact that the scheme has been approved by 90% of the members.[24] But the burden to prove unfairness may be reversed where the Tribunal finds that the take-over bidder and the accepting majority are the same parties. This was the position in *Bugle Press Ltd, Re*[25].

> Here the scheme of take-over was adopted to get rid of a minority. The ninety per cent majority formed a new company which made the offer and it was approved by them. They then attempted to acquire the minority interest in the terms of the scheme.

It was held that the burden of proving fairness lay on them and the mere fact that the compensation was fair was not sufficient to discharge the burden.

Similarly, an attempt to impose new liability on a minority without their consent will be foiled. A well-known authority is *Bisgood* v *Henderson's Transvaal Estates Ltd*[26]:

> A company had issued fully paid £1 shares. A scheme of reconstruction was approved by the requisite majority under which the company's undertaking was to be transferred to a new company. Each shareholder was to receive an equal number of shares in the new company but only 17 sh. 6d. credited as paid.

The court granted an injunction on the application of the minority shareholders as the scheme would have enabled the new company to extract more capital from holders of fully paid shares.

Take-over Offer to be from Single Company

It has been held by the Privy Council in *Blue Metal Industries Ltd* v *Dilley*[27] that the power of acquisition can be exercised only when the offer of take-over is made by a single company. Lord MORRIS said:

> The significance of the 90% figure is, on this view, that once a company has become so nearly a total power or parent of another company as a shareholding of 90% would represent, it should not be

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22 See H. Rajak, *Minority Rights and the Take-over bid*, (1970) 87 SALJ 12; D. D. Prentice, *Take-over bid : The Compulsory Acquisition of Dissenting Shares*, (1972) 35 Mod LR 73, considering *Carlton Holdings Ltd, Re*, [1971] 1 WLR 918 : [1971] 2 All ER 1082, where differential treatment was given. Frank Wooldrige, *Compulsory Acquisition of Shares on Take-over*, 1986 JBL 300.

23 *Hoare & Co Ltd, Re*, (1933) 150 LT 374 : [1933] All ER Rep 105; *Bugle Press Ltd, Re*, [1961] Ch 270 : [1960] 3 WLR 956 : [1960] 3 All ER 791 CA.

24 *Grierson Oldham & Adams Ltd, Re*, [1968] Ch 17, 32 : [1967] 1 All ER 192 : [1967] 1 WLR 385. *See* also the judgment of MAUGHAM J in *Dorman, Long & Co, Re*, 1934 Ch 635, where at 657 the learned Judge said that the proposal must be "such that an intelligent and honest man, a member of the class concerned and acting in respect of his interest, might reasonably approve".

25 [1961] Ch 270 : [1960] 3 WLR 956; [1960] 3 All ER 791 CA.

26 [1908] 1 Ch 743 : [1908-10] All ER Rep 744 : 98 LT 809.

27 1970 AC 827 : [1969] 3 All ER 437.

prevented from converting the other company into a wholly owned subsidiary by so small a dissenting minority as 10% or less, but should be entitled to acquire the holding of that minority. Their Lordships consider it important to bear in mind that the statutory procedure is one that involves the acquisition by a private interest of the property of another—an exceptional interference with the rights of individual ownership. It leads almost inevitably to the consequence that the powers of the section can only be invoked by a single company, for the objective is to allow a 90% owned subsidiary to be converted into a 100% subsidiary, that presupposes a single parent.

Adequacy of Information

Inadequacy of information may be another ground for the Tribunal to withhold its sanction. In one of the cases, however, the court refused to help a minority shareholder although it believed with him that the information given to him was too meagre.[28] Now the Central Government has the power to prescribe the information that ought to be given in an offer of take-over.[29]

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28 *Evertite Locknuts, Re*, [1945] Ch 220.

29 S. 395(4-A), which has been *added* by the Amendment Act, 1965 runs as follows:

"(4-A) (*a*) The following provisions shall apply in relation to every offer of a scheme or contract involving the transfer of shares or any class of shares in the transferor company to the transferee company, namely:

(*i*) every such offer or every circular containing such offer or every recommendation to the members of the transferor company by its directors to accept such offer shall be accompanied by such information as may be prescribed;

(*ii*) every such offer shall contain a statement by or on behalf of the transferee company, disclosing the steps it has taken to ensure that necessary cash will be available;

(*iii*) every circular containing, or recommending acceptance of, such offer shall be presented to the Registrar for registration and no such circular shall be issued until it is so registered;

(*iv*) the Registrar may refuse to register any such circular which does not contain the information required to be given under sub-clause (*i*) or which sets out such information in a manner likely to give a false impression; and

(*v*) an appeal shall lie to the Court against an order of the Registrar refusing to register any such circular.

(*b*) Whoever issues a circular referred to in sub-clause (*iii*) of clause (*a*), which has not been registered, shall be punishable with fine which may extend to five hundred rupees."

Apart from the statutory duty the directors owe no duty to shareholders as sellers of shares. They have only to consider the interest of such shareholders in the discharge of their duty to the company. Where, however, the directors play the independent role of advising the shareholders, that role being outside their position as directors, they have to do so in good faith. They would then be responsible if they mislead the shareholders whether intelligently or negligently. *Dawson International plc* v *Coats Paton plc*, 1989 BCLC 233 CA. The court also pointed out that it is not *ultra vires* for a company for the protection of its own interests to enter into an agreement with a take-over bidder that the company will not cooperate with the rival bidders. Where currency was given to false statements with a view to prevent a rival bidder's take-over bid from succeeding, the court said that the latter's tort action for damages for wrongful interference with trade or business should be given trial on merits and not summarily dismissed. *Lonhro plc* v *Fayed*, 1989 BCLC 485 CA, affirmed, (1991) BCLC 779 HL : [1993] 3 Comp LJ 241. For a study of the working rules of the English Take-over Panel and the scope of judicial review, see *R* v *Panel on Take-Overs and Mergers, ex p Guinness plc*, 1989 BCLC 255 CA. There is also the SEBI

Offering same Terms to those whose Shares are to be Acquired

Where the class of shares which are to be transferred are already held by the transferee company to a value greater than one-tenth of the aggregate of the values of all the shares in the company of such class, the transferee company will not get the right to acquire the shares of the dissenting shareholders unless the same terms are offered to all holders of the shares of that class and the holders who approve the scheme should be nine-tenths in value of the shares to be transferred (excluding those already held) and should also be three-fourths in number of the holders of those shares.

Notice of Acquisition

When, in pursuance of any scheme or contract of this kind, shares or shares of a class in a company, have been transferred to another company or its nominee, and those shares together with other shares or any other shares of the same class are already held of the transferee company or its nominee company or its subsidiary to the extent of nine-tenths in value of the shares or the shares of that class, the transferee company is required to give a notice of the fact to the holders of the remaining shares who have not assented to the scheme. The notice must be given within one month from the date of the transfer, except when a notice has been given in pursuance of the scheme. Any such holder may, within three months from the giving of the notice to him, require the transferee company to acquire the shares in question. The transferee company then becomes entitled as well as bound to acquire those shares on the same terms on which the shares of approving shereholders were transferred or on such terms as the court may, on the application of the shareholder or transferee company, think fit to order.

Amalgamation in National Interest [S. 396]

Where the Central Government is satisfied that an amalgamation of two or more companies is essential in the public interest, then, the Government may by order notified in the Official Gazette provide for the amalgamation of those companies into a single company. The amalgamated company shall have such constitution, property, powers, rights, interests, authorities and privileges and shall be with such liabilities, duties and obligations as may be specified in the Government's order. The order may also contain consequential, incidental and supplementary provisions.

Every member or creditor of each of the companies before the amalgamation shall have, as nearly as may be, the same rights and interests in the amalgamated company as he had in the company of which he was originally a member or creditor. But if his rights in the amalgamated company are less than

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Take-over Code (Securities and Exchange Board of India Substantial Acquisition of Shares and Take-overs) Regulations 1994. Regulations 6, 9 and 13 were considered by the securities Appellate Tribunal Mumbai in *Sharad Doshi v Adjudicating Officer*, (1998) 29 Corpt LA 383 (SAT), time-limit for public announcement, non-compliance is not merely technical lapse so as to warrant a leniency; ignorance of the regulations or their import is also no excuse.

those, he shall be entitled to compensation. The Government may prescribe some authority for the assessment of compensation and it will be paid by the company resulting from the amalgamation.[30]

Before making any order of amalgamation, the Central Government is required to send a copy of the proposed order in draft to each of the companies concerned. This is necessary to enable such companies to file their objections and suggestions. The period for filing objections shall be fixed by the Government, but should not be less than two months. The Government may modify the draft order in the light of any suggestions so received.

Copies of every such order have to be laid before both Houses of Parliament at the earliest convenience.

Preservation of Books and Papers of Amalgamated Company [S. 396-A]

Where a company has been amalgamated with another company under any of the above provisions of the Act, or whose shares have been acquired by another company, the books and papers of such a company shall not be disposed of without the prior permission of the Central Government. Before granting such permission, the Government may appoint a person to examine the books and papers for the purpose of ascertaining whether they contain any evidence of the commission of an offence in connection with the promotion or formation of or the management of the affairs of the company.

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30 See *Boiron* v *SBL Ltd*, (1998) 30 Corpt LA 21 CLB, foreign collaborator holding 30% as against 60% Indian promotor, expansion of capital base for amalgamation, the promoter resolved for rights issue, collaborator preferred Government loans, promoter to reconsider his decision, amalgamation in national interest could be ordered.