(2006) 06 AP CK 0124

In the Andhra Pradesh High Court

Case No : Company Appeal No. 2 of 1999

A.P. Civil Supplies Corpn. Ltd. APPELLANT

Vs

Delta Oils and Facts Ltd. RESPONDENT

Date of Decision : 06-06-2006

Acts Referred:
Companies Act, 1956 — Section 10E(5), 235, 235(2), 237, 297

Citation : (2007) 73 SCL 242

Hon'ble Judges : S. Ananda Reddy, J

Bench : Single Bench

Advocate : M. Anil Kumar, for the Appellant; CH. Ramesh Babu and V.S. Raju, for the Respondent

Final Decision : Allowed

Judgement

S. Ananda Reddy, J.—This appeal is filed by the unsuccessful petitioner before the Company Law Board, viz., A.P. State Civil Supplies Corporation, by which an application filed by the appellant u/s 235(2) of the Companies Act, 1956 (hereinafter referred to as "the Act"), seeking direction to the Central Government for appointment of Inspectors to investigate into the affairs of the 1 st respondent-company during the tenure period of the 2nd respondent as Managing Director of the said Company, was dismissed.

2. It is stated that the 1st respondent was formed as a joint venture company between the appellant Corporation and the respondents 2 to 4, who were the Managing Director and the Directors of the Company in question, having contributed equally by the appellant and the respondents to the share capital of the Company and the said Company was run by the 2nd respondent as Managing Director, by looking after day-to-day affairs of the Company. Though the Company did well from its incorporation in the year 1982 and made profits over the period of six years, but however, during the years 1989-90 and 1990-91 due to mismanagement of the 2nd respondent, the Company suffered huge losses and the entire reserves that were built up as well as share capital was eroded

completely. Since the said losses happened due to the mismanagement of the 2nd respondent-management, audit was conducted for the year 1989-90 and the said audit report shows that the 2nd respondent had in fact committed illegalities so as to cause loss to the Company to his benefit.

3. An application was filed by the Corporation u/s 235(2) of the Act, seeking an order for investigating into the affairs before the Company Law Board. The Corporation relied upon the Management Audit Report as well as statutory Audit Report for the year 1990-91, which clearly points out the misdeeds of the Managing Director, the 2nd respondent herein, therefore, sought for an order for investigating into the affairs. But, however, the respondents 2 to 4 who were the Managing Director and the Directors filed some explanation before the Management Auditor, basing on which some modifications are said to have been effected for the year 1989-90. But insofar as the statutory audit report for the year 1990-91 is concerned, it remains in tact and there was in fact no explanation even by the contesting respondents. The Company Law Board however, after considering the rival contentions and relying upon the explanation of the 2nd respondent before the Management Auditor, who is said to have submitted a second report, under which he had omitted the findings with reference to the certain charges which were originally found against the 2nd respondent and further observing that no material was placed before it to substantiate the claims of the Corporation as to the alleged mismanagement, the Company Law Board dismissed the application. Aggrieved by that, the Corporation has come up with the present appeal.

4. Sri M. Anil Kumar, counsel appearing for the appellant contended that the Company Law Board did not appreciate the material available on record. It was his case that it is not necessary for the Corporation to prove the case in absolute terms before the Company Law Board except making out a prima facie case, showing the irregularities that have been committed by the Management which warrants a deeper investigation into the affairs of the Company. The learned Counsel contended that though the Company Law Board relied upon second Management Auditor''s Report dated 31-12-1990 to give benefit of doubt to the 2nd respondent, the then Managing Director of the Company in question, failed to consider the Statutory Audit Report, which is also in conformity with the first Management Auditors Report dated 16-10-1990. The learned Counsel contended that when the Company Law Board completely failed to consider the findings arrived at by the statutory auditor, which contains the facts and figures, the impugned order, passed by the Company Law Board, is clearly illegal and unsustainable as it has failed to consider the relevant material on record and, therefore, sought to set aside the same.

5. Sri V.S. Raju, counsel appearing for the respondents 2 to 4, on the other hand, supported the order of the Company Law Board, contending that the Company Law Board on appreciation of the entire material on record, exercised its discretion against the appellant-corporation. Since the Company Law Board had

exercised its discretion on consideration of the material on record, the said discretionary order does not warrant any interference by this Court in the present appeal. The learned Counsel also contended that the Company Law Board gave categorical findings that the Corporation failed to substantiate its claim with respect to the alleged mismanagement or misdeeds said to have been committed by the 2nd respondent as Managing Director of the Company by filing any comparative statement with respect to the working of other similarly placed companies. In the absence of any such material, the impugned order does not call for any interference. The learned Counsel also relied upon various decisions in support of his contention, which shall be considered later.

6. Admittedly, the appellant/applicant A.P. State Civil Supplies Corporation Limited is a Company fully owned by the Government of Andhra Pradesh, which was formed with an object of procuring as well as distribution of essential commodities to the public. In the policy of the State to develop agro based industries, the State owned Corporation along with private individuals in order to establish an unit, formed the Company viz, the Delta Oils and Facts Private Limited with equal participation. The said Company had established its units in West Godavari District of Andhra Pradesh where rice production was the predominant. The unit was established to use rice bran for producing rice bran oil. The Company had its issued, subscribed and paid up capital of Rs. 24 lakhs, divided into 24,000 equity shares of Rs. 100 each fully paid up, of which 50 per cent of the capital was contributed by the Corporation while the other co-promoters, respondents 2 to 4 contributed the remaining 50 percent of the share capital. The said Company was incorporated on 18-2-1982 as a joint venture company. As per the joint venture agreement, the appellant Corporation has the right to appoint its nominee Director as Chairman while the 2nd respondent Sri J. Ramachandra Rao was designated as a Managing Director while the other two respondents are the Directors. Till 1988-89 the Company was making good profits. Only during the year 1989-90 the Company reported heavy losses, which has prompted the appointment of Management Auditor to go into the books of account of the Company and to submit a report. As per which, the Management Auditor, one Anjaneyulu and Co., Chartered Accountants, submitted a report on 16-10-1990. As per the said report, the Management Auditor pointed out the mismanagement with reference to eight items, which are detailed below:

SL. No. Particulars 16-10-1990 1. Opening Sundry Debtors transferred to 74,293-00 Transport Charges (Anncxure-I) 2. Shortage of Oil in Oil Production (Yield) 18,33,886-00 (Annexure-II) 3. Closing Stock Excess shown as on 31-3-1990 8,51,510-00 4. Excess Transport Charges paid towards 62,000-00 Bamboo Dust Transportation 5. Inflated Payment for purchases from 2,07,743-85 M/s. Srinivasa Trading Company 6. Inflation of Transport Charges for purchase of 3,45,196-00 Bran from M/s. Srinivasa Trading Company 7. Coal Charges debited to Profit & Loss A/c. to be 58,33 1-00 transferred to Advances A/c. 8. Loss on Contract for supply of Oil 1,77,650-00 Total: 19,07,589-85 7. As per the said Management Auditor Report, an amount of Rs. 19,07,589.85ps was suffered at loss to the Company because of the mismanagement of the Managing Director, the 2nd respondent herein. Had this amount was not caused loss to the Company, the Company would have declared a profit of Rs. 12,26,947.85ps as against the loss declared of Rs. 6,80,642.00. Similarly the statutory audit report for the year 1990-91 also shows similar losses caused to the Company under as many as 14 items specified in the said auditor''s report. In view of the above losses caused, the Corporation approached the Company Law Board with an application u/s 235(2) of the Act, seeking for an order of investigation into the affairs of the Company.

8. The said application was contested by the contesting respondents, contending that after the first Management Auditor''s report dated 16-10-1990, the 2nd respondent submitted certain explanations with reference to the items found against him, basing on that the Management Auditor submitted another report dated 31-12-1990, as per which, the original findings against the 2nd respondent were omitted in respect of three of eight items, and further there was substantial reduction with reference to two other items and thus, as per his own findings, instead of profit as per the first report, the Company would have suffered a loss of Rs. 2,93,967 instead of Rs. 6,80,642 as was originally declared. Therefore, it was contended that since the first report was modified by the same auditor, further no material was brought on record by the Corporation to substantiate its claim as to the alleged mismanagement or misappropriation of any of the funds of the Company, there was no case for ordering investigation into the affairs of the Company.

9. The Company Law Board accepted the claim of the respondents on both the grounds, that the first audit report was diluted by the second audit report by the same auditor, after considering the explanation of the 2nd respondent, further no independent material was brought on record by the Corporation to substantiate the claim of the Corporation that there was mismanagement on the part of the 2nd respondent, which had resulted in suffering loss by the Company. But the said findings are assailed in the present appeal, contending that the material placed on record is sufficient to come to the prima facie conclusion that mismanagement in fact had committed warranting an order for further investigation into the affairs of the Company.

10. At this juncture, it would be appropriate to consider the (items of) defects found by the Management Auditor in the first report and the explanation offered by the respondents. The first item as is referred to in the comparative statement filed by the auditor relates to the opening sundry debtors transferred to transport charges. The said item relates to Rs. 74,293. The allegation is that the sundry debtors amounts were transferred to the transport charges without there being any explanation. The explanation to this allegation is that the said amount represents old balance in the sundry debtors, which are not recoverable. These amounts have been carried from the previous years pending adjustments for quality rebates, analysis differences, transportation etc. Debiting the amounts to

transportation was a clerical mistake and that has been rectified by transfer to rebates and discounts. This explanation was not accepted even by the auditor as per his second report. From the said explanation, it is clear that by the date of the audit that was conducted by the Management auditor, there was no rectification as was alleged. The alleged rectification, if any, was said to have been made only after the auditor''s report, which is apparently made in order to cover up the illegality.

11. The second item relates to shortage of oil in oil production. The allegation against the management is that due to mismanagement short production of oil was shown to a tune of Rs. 18,33,886. The explanation given by the respondents is not clear. They simply stated that the opening balance of bran was 535.46 MT and thereafter the respondents did not even state what is the quantity of bran that was purchased during the year and what was the content as per the estimation and what was the real production. The respondents gave only hypothetical explanation showing that there was an excess production of 72.541 MT. It is not known how even the management auditor has accepted this explanation when the respondents did not give exact quantities of rice bran of different varieties that had been purchased during the year.

12. Similarly excess of closing stock was shown as on 31 -3-1990 to the tune of Rs. 8,51,510. The Management Auditor found that the sales as per the production records was 1671.803 MT, whereas as per the Invoices and Sales Register it was 1721.204 MT, therefore, there was a short production of 54.540 MT as per sales register and closing stock has been arrived at basing on the production record and the same was adopted as 124.155 MT for preparing the final accounts as on 31-3-1990. But, however, the Management Auditor, basing on the stock shown as per the production register as well as the sale invoices and sale register, the closing stock was found at 69.315 MT. Thus, there is a shortage of 54.540 MT valued at Rs. 8,51,510. But, however, in the explanation, the 2nd respondent tried to explain away by taking the sales as per the sale register at 1721.151 MT and adding the closing stock at 124.121 MT and from out of the total stock of 1845.272 MT, deducting opening stock of 129.495 MT, arrived the production during the year at 1715.777 MT. This explanation clearly shows that the 2nd respondent would like to arrive at the production by relying upon the other figures of sales as well as opening and closing balance, but not relying upon the entries made in the production register which was adopted by the Management Auditor. Therefore, there was no case for accepting such explanation.

13. Another issue relates to inflation of transport charges for the purchase of rice bran from M/s. Srinivasa Trading Company to the tune of Rs. 3,45,196. It was stated that the said concern relates to one B. Venkata Rao, who is said to be brother-in-law of the 2nd respondent J. Ramachandra Rao and the brother of Smt. J. Lakshmi, the Director of the Company. It is stated that the Company purchased 4154.877 MT. On verification of the purchases made from the other

concerns, traders and millers, there is always a price variation of Rs. 10 to Rs. 5 per quintal throughout the year and the entire transport charges are paid by the Company. It was also found by the Management Auditor that M/s. Srinivasa Trading Company was carrying on its business from the factory premises itself which is evident from the bills issued by the said concern which bear no address but bears the telephone numbers of the Company in question. The said Srinivasa Trading Company was purchasing the material and transferring it to the Company, whereas the transport charges from the millers from whom M/s. Srinivasa Trading Company was purchasing are borne by the Company. It was also found that the transport charges from the traders'' godown or stock point to the Company are to be borne by the Company. The Management Auditor was also found that though the Directors are interested in the transactions, no disclosure of interest was made in the Board of Directors meeting, which is mandatory under the provisions of the Act. The Management Auditor has also arrived at the excess sale consideration paid to the tune of Rs. 2,07,743.85ps, working out the excess sale consideration paid at Rs. 5 over and above the rates at which the Company paid to other similarly placed suppliers.

14. It was also found that excess transport charges were paid to the Bomboo Dust Transportation. The Bomboo Dust which was used as substitute to coal, was transported from the suppliers point through the lorry owned by Smt. J. Lakshmi, the Director of the Company and the wife of the Managing Director. The transport charges are being paid at the rate of Rs. 75 per MT, there is no written agreement between the Company and the owner of the lorry. The vehicle was used throughout the year and transported around 2,400 MT. The Auditor''s report shows that local enquiries reveal that transport charges were at Rs. 50 per tonne as per the prevailing market rate. Thus, an excess of Rs. 60,000 was paid. It is stated that the Company purchased coal from Singareni Collieries Limited during the year and the same was transported through Sri Balaji Lorry Suppliers, Manuguru. Lorry freight charges paid for the coal received and invoices sent by Singareni Collieries Limited are not reconcilable and in view of the fact that they are not tallying with the invoices and lorry freight charges shows that there was misappropriation in the coal transaction which was estimated at Rs. 58,331.

15. The Management Auditor also found that with reference to the same contract for supply of oil with one M/s. Amrit Banaspati Company Limited, Rajpura, Punjab, the Company during the year debited Rs. 1,77,650 as loss towards failure of delivery of oil as per the contract agreement on or before the due dates. The contract rate per metric tonne is Rs. 14,500, Rs. 14,650, Rs. 15,125 and Rs. 15,980. At those rates it was agreed to supply 20 MT each. But, however, though the Company has got sufficient stocks during that period i.e. in June and July, 1989, it did not supply the material to the purchaser, but settled at the rate of Rs. 17,200 with reference to the first two agreements and at Rs. 17,500 in respect of other two agreements and thus, paid by way of settlement a sum of Rs. 1,77,650. The Management Auditors found that the management could not be able to satisfy the reason for non-fulfilling of the contract even

though there is sufficient stock. The explanation of the 2nd respondent was that the said settlement was due to the failure to supply the stock as a result of non-availability of railway wagons. It is stated that there were heavy and unprecedented floods in the month of July, 1989, therefore, the Railways Department failed to supply the wagons and hence the Company could not fulfil the supply contract and thus settled for the above amounts, though it was agreed that the stock was sold locally at Rs. 17,000 to Rs. 17,200 per metric tonne. This explanation also shows that the Company had settled for higher price, even assuming that the failure to supply was due to non-supply of wagons by the railways. But still when the market rate was Rs. 17,000 to Rs. 17,200, how the Company could settle at higher rate of Rs. 17,500 per metric tonne, for which there was no explanation.

16. Similarly, for the year 1990-91 the statutory auditor found almost identical defects such as shortage in oil production, shortage in yield, inflated stocks by filing statements to the State Bank of India availed higher credit facility and in fact had drawn the amounts from the State Bank of India, basing on the higher credit facility provided showing inflated stocks which were subsequently found not available even by the Bank. With reference to the said statutory audit report, there was absolutely no explanation by the 2nd respondent, and in fact even the Company Law Board did not consider this report, but merely observed that the Corporation did not produce any material to substantiate its claim of misappropriation by the 2nd respondent. It is stated that even the Company Law Board found that the 2nd respondent had effected heavy withdrawals over Rs. 67 lakhs from the State Bank of India by showing inflated stocks though such stocks were not in fact available to give as security. But, however, further found that the Corporation did not produce any other independent material to substantiate its claim that only the present Company has suffered loss while other similarly placed units have made profits. The said observation of the Company Law Board may not be proper and just, especially in the light of voluminous material available on record which clearly and categorically shows that the 2nd respondent had indulged in showing false statements of stocks in order to avail the higher credit facility, and in fact amounts were even drawn from the said Bank basing on the said statement. The observations made by the Company Law Board that the said allegation is subject-matter of a civil suit where trial is yet to commence. The said observation is not proper and just insofar as the suit is concerned, it is a suit for recovery of money, which was advanced by the Bank to the Company where even respondents 2 to 4 have given their personal guarantees. The issue whether the 2nd respondent showed a false statement of slocks may not be any issue to be considered in the said suit. There is a categorical statement made by the Bank that the 2nd respondent showed the stocks worth Rs. 73.56 lakhs as on 1-5-1991, which was later modified as on 25-5-1991 the statement of which was delivered to the bank on 1-6-1991 showing the stock value as Rs. 18,03,372, but the bank people verified the stocks on 25-5-1991 itself and found that the 2nd respondent had mostly

diverted the stocks and in fact even the staff of the Company refused to provide the stock register for verification of the stock, and in fact it was found that no stocks arc available by 1-6-1991, which prompted the bank to file the suit.

17. The above incorrect or false statements of closing stocks furnished by the 2nd respondent on behalf of the Company is also evident from the findings of the Statutory Auditor for the year 1990-91, where it was observed that a scrutiny of the monthly stock statements submitted to the State Bank of India reveals a wide variance in the quantities of finished goods and raw materials. The reasons (or these discrepancies require to be explained. A comparative statement of the quantities mentioned in the Bank Statements and the actual stocks as per the Company''s records are shown in Annexure-13 and the same is as under :

Rice Bran Oil De-oiled Bran Boiled Bran Raw Bran Month Bank St. Actuals Bank St. Actuals Batik St. Actuals Bank St. Actuals MT MT MT MT MT MT MT MT 1990 April 146.261 99.324 1056.793 1225.410 218.170 193.883 452.464 187.535 May 122.987 102.528 965.786 1249.568 335.277 201.108 427.030 2.760 509.050 June 141.911 75.027 1031.979 1186.641 165.458 32.204 443.590 19.320 July 144.111 52.065 831.559 1118.708 446.497 50.379 79.866 9.135 August 132.096 43.254 781.173 539.339 522.914 61.264 121.968 2.400 September 114.139 18.957 908.381 625.399 541.352 55.420 91.675 2.090 October 115.751 20.559 778.415 475.933 580.427 98.660 97.594 8.005 November 106.139 10.947 925.155 618.063 415.298 97.321 89.589 ? December 146.882 32.040 1105.533 771.177 584.267 144.670 97.594 10.015 1991 January 107.560 12.282 832.503 405.447 529.260 260.225 215.529 144.655 February 137.416 25.098 858.835 339.785 525.228 279.521 110.604 61.665 March 129.699 23.496 697.571 189.516 581.597 279.150 145.027 76.038 There is no explanation from the 2nd respondent as to the above discrepancies.

18. The Statutory Audit Report for the year 1990-91 reveals that sales of De-oiled bran was effected in favour of M/s. Venkatarama Poultry Farm, Undrajavaram at concessional rates. The said Farm belongs to the Managing Director Dr. J. Ramachandra Rao, who is the Managing Partner of the said Farm. His interest in that Farm was not disclosed as is required under Sections 297 and 301 of the Act. Further the sale to all other firms were made ex-factory, while the sales effected in favour of M/s. Venkatarama Poultry Farm was based on delivery at their premises without charging any amount for transportation. The said Firm was also allowed unduly long credit for the goods sold to it, which had resulted in substantial benefit to the said Firm at the cost of the Company.

19. The Statutory Audit Report also shows that there was a loss of 190 MT of De-oiled Bran due to cyclone damage in May, 1990, and the same was used as boiler fuel as per the records and the records shows that the Company did not recover any amount from the Insurance Company towards damages. The report also shows that there were RB Oil debtors to the extent of . 8,86,795.70ps as on March 31, 1991, out of which an amount of Rs. 5,87,139.98ps has been written

off as irrecoverable in the subsequent period and a further credit of Rs. 96,992 has been given to M/s. Amrit Banaspati Company, Rajpura. Though these amounts were treated as good for recovery in January, 1991, later they were treated as bad without there being any proper explanation. In fact from the material on record, it is clear with reference to the same M/s. Amrit Banaspati Company, the Company itself effected payment of Rs. 1,77,650 by way of settlement of sale transaction of oil and it is not known how if certain amounts were due to the Company from the said M/s. Amrit Banaspati Company Limited, the Company has not adjusted against the amounts due from it. The above irregularities noted by both the Management Auditor as well as Statutory Auditor clearly show that there is a prima facie case of fraud played on the Company by its Managing Director so as to cause loss to the Company, therefore, the said irregularities requires a deeper and thorough investigation by the appropriate authorities. Therefore, the view taken by the Company Law Board may not be proper and just in coming to conclusion that the Corporation did not substantiate its allegations by producing additional material, hence there is no case for ordering investigation, as contemplated u/s 235 of the Act.

20. At this juncture, it would be appropriate to refer to the judgments relied upon by the counsel for the parties.

21. The learned Counsel for the appellant relied upon a decision of this Court in Uunet India Limited and Others Vs. I.C. Rao and Others, where a learned Single Judge of this Court while considering the scope of the enquiry u/s 237 of the Act held that it must deal only with the said power, which is expressly conferred on the Company Court to order investigation, which is one of the modes for getting the investigation by the Central Government. It was held that the Court while considering an application under the said provision has no power to pass any other interim orders or otherwise.

22. In S. Indrasena Reddy v. Indo Rock Granites Ltd. C.P. No. 140 of 1997, dated 8-11-2000 the Company Judge of this Court while considering an application u/s 237 of the Act, while denying the other reliefs that are sought for, ordered the application directing the Central Government to appoint on or more competent persons as Inspectors to inspect the affairs of the respondent-company.

23. The learned Counsel for the respondents, on the other hand, relied upon the following decisions :

In The Barium Chemicals Ltd. and Another Vs. The Company Law Board and Others, the Apex Court has considered the scope of the provisions of Section 237(b) of the Act, where the Central Government as well as even the Company Law Board were empowered for appointment of Inspectors for investigation into the affairs of the Company, similar to the one u/s 235 of the Act. In that case, the order of appointment of Inspectors was assailed in appeal before the Apex Court by the Company as well as by its Managing Director. The Court, after considering the provisions of Section 237, observed that the authority competent to order investigation must have a subjective satisfaction of the matters referred to in Sub-clauses (i) to (iii) of Clause (b). It was further observed that once it is conceded that the formation of the opinion of the Board is intended to be subjective, the question would arise: what is that about which the Board is entitled to form an opinion? The opinion must necessarily concern the existence or non-existence of facts suggesting the things mentioned in the several Sub-clauses of Clause (b). An examination of the section would show that Clause (b) thereof confers a discretion upon the Board to appoint an Inspector to investigate the affairs of a Company. The words "in the opinion of" govern the words "there are circumstances suggesting" and not the words "may do so". The words "circumstances" and "suggesting" cannot be dissociated without making it impossible for the Board to form an "opinion" at all. The formation of an opinion must, therefore, be as to whether there are circumstances suggesting the existence of one or more of the matters in Sub-clauses (i) to (ii) and not about anything else.

24. Further it was observed in para 20, to sum up, then, our conclusions may be stated thus: The discretion conferred on the Central Government by Section 237(b) to order at investigation and delegated by it to the Company Law Board is administrative, that it could be validly exercised by the Chairman of the Board by an order made in pursuance of a rule enacted by the Central Government u/s 642(1) read with Section 10E(5), that the exercise of the power does not violate any fundamental right of the company, that the opinion to be formed u/s 237(b) is subjective and that if the grounds are disclosed by the Board the Court can examine them for considering whether they are relevant.

25. In Rohtas Industries Vs. S.D. Agarwal and Others, the Apex Court while considering the scope of enquiry under Sections 235 - 237 of the Act, observed :

The power conferred on the Central Government u/s 235 as well as u/s 237(b) is a discretionary power whereas the Central Government is bound to appoint one or more competent persons as Inspectors to investigate the affairs of a company, and to report thereon in such manner as the Central Government may direct if the company by special resolution or the Court by order declares that that the affairs of the company ought to be investigated by an Inspector appointed by the Central Government u/s 237(a)(i)(ii). It may be noted that before the Central Government can take action u/s 235 certain pre-conditions have to be satisfied. In the case of an application by members of the company under Clause (a) or (b) of Section 235, the same will have to be supported by such evidence as the Central Government may require for the purpose of showing that the applicants have good reasons for requiring the investigation, and the Central Government may, before appointing an Inspector, require the applicant to give security for such amount not exceeding Rs. 1,000 as it may think fit for payment of the costs of the investigation. From the provisions contained in Sections 235 and 236 it is clear that the Legislature considered that investigation into the affairs of a company is a very serious matter and it should not be ordered except on good grounds. It is true that the investigation u/s 237(b) is of a fact-finding nature. The report submitted by the Inspector does not bind anybody. The Government is not required to act on the basis of that report, the company has to be called upon to have its say in the matter but yet the risk? it may be a grave one ? is that the appointment of an Inspector is likely to receive much press publicity as a result of which the reputation and prospects of the company may be adversely affected. It should not, therefore, be ordered except on satisfactory grounds.

26. In Harigangu Cement Ltd. v. CLB 1988 64 Comp. Cas. 603, a Division Bench of the Bombay High Court, while considering the scope of Section 237(b), held :

The discretionary powers vested in the Company Law Board u/s 237(b) of the Companies Act are of a very wide nature and the said powers have to be exercised with great circumspection and retrospection and in a judicious manner. The powers u/s 237 have been conferred on the Central Government in the faith that it will be exercised in a reasonable manner. The Department of the Central Government which deals with companies is presumed to be an expert body in company law matters. Therefore, the standard that is prescribed u/s 237(b) is not the standard required of an ordinary citizen but that of an expert. Hence, if the Court comes to the conclusion that no reasonable authority would have passed the impugned order on the material before it, then the same is liable to be struck down.

27. In Ashoka Marketing Ltd. v. Union of India 1981 51 Comp. Cas. 634, a Division Bench of the Delhi High Court, while considering the scope of Section 237 of the Act, observed that the words ''in the opinion of the Central Government'' in Section 237(b), indicate that the opinion must be formed by the Central Government and it is implicit that the opinion must be an honest opinion. Again, an action, not based on circumstances suggesting an inference of the enumerated kind, will not be valid. In other words, the enumeration of the inferences which may be drawn from the circumstances postulate the absence of a general discretion to go on a fishing expedition to find evidence. The formation of opinion is subjective but the existence of circumstances relevant to the inference as the sine qua non for action must be demonstrable.

28. The question whether circumstances have been shown to exist from which, reasonably, an inference of the nature contemplated by the provision can be drawn is a matter for judicial consideration. It is not sufficient for the Board to merely allege some facts which raise some suspicion in order to enable it to enter into a fishing expedition or to undertake an investigation as a result of which possibly some case could be made out against the company. The term "fraud" connotes actual dishonesty and, however, much the Court may disapprove of a personal conduct, it must consider whether the person has been guilty of dishonesty. Misfeasance results from an act or conduct in the nature of a breach of trust or an act resulting in a loss to the company. Misconduct of promoters or directors as understood in the Companies Act means not misconduct of every kind but such as has produced pecuniary loss to the

company by misapplication of its assets or by other acts.

29. In Delhi Flour Mills Co. Ltd. In re 1975 45 Comp. Cas. 33 a learned Single Judge of the Delhi High Court, while considering the application filed u/s 237, observed that the object of investigation u/s 237 is to discover something which is not apparently visible to the naked eye. Where a petition discloses merely facts, which are apparent from the balance sheet of the company, an investigation will not be ordered. At least prima facie evidence should exist concerning circumstances, which would lead to the conclusion that an investigation was necessary.

30. In Mrs. U.A. Sumathy v. DIG Vijay Chit Fund (P.) Ltd. 1983 53 Comp. Cas. 493, a learned Single Judge of the Kerala High Court, while considering the scope of Section 237 of the Act, observed that Clause (a)(ii) of Section 237 of the Companies Act, 1956 does not lay down the circumstances that are to be proved and the materials on which a Court could act. But that does not mean that mere allegations are sufficient. A Court can act only on the materials placed before it and the materials should at least be such as to satisfy the Court that a deeper probe into the company''s affairs is desirable in the interests of the company itself such as would result in proceedings being taken under Sections 242 - 244. No investigation could be ordered merely because a shareholder feels aggrieved about the manner in which the company''s business is being carried on.

31. From the above decisions it is clear that before ordering appointment of Inspectors for investing into the affairs of the Company, there must be material to prove prima facie that certain irregularities are committed, or fraud has been played on the Company by the Directors and the decision has to be taken subject to the satisfaction on the material placed and not otherwise. Therefore, the facts of the present case have to be examined in the light of the above decisions.

32. The Corporation, which filed the application u/s 235 of the Act, pleaded that the Managing Director and other Directors have mismanaged the affairs during the years 1989-90 and 1990-91 so as to cause loss to the Company in question by completely eroding the profits that are accumulated over a period of years as well as the share capital contributed by both the Corporation and the Directors. For the first time, as the Company had declared huge loss during the years under reference, the Management auditor was appointed to go into the irregularities and in fact the Management Auditor found for the year 1989-90 that irregularities have been committed so as to cause loss to the Company. The irregularities are in the nature of causing loss to the Company while benefiting the persons, who are in the management. Though it was claimed that the second respondent-Managing Director submitted his explanation to the first Management Auditor''s report, basing on which certain of the findings recorded against the 2nd respondent in the original report were diluted, though with reference to certain of the allegations, they were found even after the explanation against the 2nd respondent. Therefore, it was contended before the Company Law Board that there is no cause for further investigation into the matter. But even the

statutory audit report for the year 1990-91 is almost on the same lines as that of the first management auditor''s report, where it was found that the Managing Director has committed irregularities in the nature of causing loss to the Company while at the same time benefit either to himself or to his relatives. There is absolutely no explanation with reference to the said statutory auditor''s report. Even the Company Law Board also failed to consider the said report, though it was available on record. Therefore, it is a clear case, where a deeper and elaborate investigation is required. As the statutory report was not considered by the Company Law Board, in the normal course, the matter would have been remanded to the Company Law Board for fresh consideration. But in the present case, the alleged irregularities relate to the period 1989-90 and 1990-91, and the Company Law Board passed its order as early as on 19-3-1997. Therefore, nearly 9 years have elapsed after the Company Law Board''s Order; and, therefore, it would not be appropriate to remand the matter again to the Company Law Board. Further, this Court on consideration of the material on record has come to the conclusion that the material placed on record prima facie shows that fraud has been played by the Managing Director as well as other Directors not only to get the benefit to themselves but also causing loss to the Company in question. As is evident from the findings recorded by the Management Auditor''s report as well as the statutory audit, it is no doubt true that the Company Law Board has got discretion to order for appointment of Inspectors, but such discretion has to be exercised judiciously. Here, in the present case, the Company Law Board simply negatived the claim of the Corporation for ordering an investigation on the ground that the Corporation did not bring on record any further evidence to support their case. But in the light of the material already available, no further material is required, and the material already on record prima facie proves that irregularities have been committed by the Management, especially where transactions were carried out with the persons, who are closely related to the Managing Director and the Directors, which had resulted in monetary loss to the Company in question.

33. Under the above circumstances, the impugned order passed by the Company Law Board is set aside and the application of the Corporation is ordered, directing the Central Government to appoint one or more Inspectors to investigate into the affairs of the Company in question viz., M/s. Delta Oils and Facts Limited so as to make necessary investigation as to its affairs.

34. The Company Appeal is accordingly allowed. No costs.

