
(1978) 04 DEL CK 0017

In the Delhi High Court

Case No : Civil Writ Petition No. 918 of 1974

Ashoka Marketing Ltd.

APPELLANT

Vs

Union of India (UOI)

RESPONDENT

Date of Decision : 26-04-1978

Acts Referred:

Citation : (1981) 51 CompCas 634

Hon'ble Judges : T.V.R. Tatachari, C.J;S. Ranganathan, J

Bench : Division Bench

Advocate : A.K. Sen and Leila Seth and B. Mohan, for the Appellant; K.M. Kataria, for the Respondent

Final Decision : Allowed

Judgement

S. Ranganathan, J.—This is a writ petition filed by Ashoka Marketing Ltd. (hereinafter referred to as " the company " or AML) for the issue of a writ of certiorari to quash the orders passed on December 31, 1973, June 26, 1974, and July 2, 1974, by the Company Law Board (hereinafter referred to as "the Board") and an order dated July 2, 1974, passed by the Government. The Union of India and the Secretary, Ministry of Law, Justice and Company affairs, have also been made respondents.

2. The order dated December 31, 1973, passed by the Board is an order u/s 237(b) of the Companies Act, 1956, appointing a firm of chartered accountants as inspector to carry out an investigation into the affairs of the company during the period from March 1, 1966, to December 31, 1973, and " to report thereon to the Company Law Board pointing out, inter alia, all irregularities and contraventions of the provisions of the Companies Act, 1956, and of any other law and the person or persons responsible for such irregularities or contraventions " on or before June 30, 1974. The reason why the Board considered this action necessary appears from the first paragraph of the order which contains the preamble :

Whereas in the opinion of the Company Law Board there are circumstances suggesting that the persons concerned in the management of the affairs of the company have in connection therewith been guilty of fraud, misfeasance and other misconduct towards the company and its members "

which is nothing more than a repetition of the language of Section 237(b)(ii) as to the circumstance warranting the appointment of an inspector under that provision. The grievance of the company is that there were no such circumstances in existence on the basis of which the Board could have formed such an opinion or ordered such an appointment. In the writ petition, the company has sought to substantiate its plea on the basis of the following allegations.

3. The company had been incorporated in 1948 and was carrying on business as traders, exporters, selling agents, dealers in stocks, shares and investments and for some time in the manufacture and sale of plywood. It had also recently commenced a business in the manufacture and sale of electronic goods. It had built up a very efficient and effective organisation and had been carrying on its business and activities scrupulously in accordance with law. It has a respectable board of directors. It maintained regular books of account and records ; its turnover was increasing from year to year ; its profits were reasonable and it was also declaring reasonable dividends. While so, on April 11, 1963, the Govt. of India ordered an investigation into its affairs under ss. 237(b) and 249(1) of the Companies Act, 1956, but this order was quashed by the High Court of Calcutta by its judgment dated March 7, 1969. In the meantime, the Registrar of Companies had been making several enquiries and, to the understanding of the company, he was satisfied with the information and Explanation given to him. In September, 1972, the Board, acting u/s 209(4)(b)(ii) of the Companies Act had appointed one Sri Sooraj Kapoor, to inspect the company's books. He had also called for Explanation, information and books from the company. The company's affidavit specifically avers in para. 7 :

" So far as your petitioner is aware there has been no complaint by the inspector of any fraud and/or misfeasance and/or misconduct and/or irregularity and contravention in the business or affairs of the company, Nor had, to the knowledge of the company, any shareholder or creditor of the company made any such allegation.

In these circumstances, the order dated 31-12-1973 was without any basis or justification. "

4. It is pointed out that the order does not set out any circumstance or material leading to the formation of the opinion expressed therein. Therefore, soon after the order was received on 7-1-1974, the company applied to the board for a review of the order setting out all the above facts, pointing out that the provisions of Section 237 were drastic and should not be commenced " unless there are satisfactory grounds supported by relevant and cogent materials and

evidence " and without such materials an inspector should not be given " arbitrary and untrammelled powers to make a fishing inquiry and to investigate into any affair of your petitioner which is not authorised under the law " during the period from March 1, 1966, till the date of the order. The company offered to furnish any information that may be needed in respect of any particular transactions and prayed that the order for a general investigation be cancelled. This petition was rejected by the Government and the Company Law Board and hence this writ petition by which the petitioner requests this court to quash the order u/s 237(b) dated December 31, 1973, the letter dated June 26, 1974, by which the Company Law Board extended the period for the inspector's report till December 31, 1974, and the orders dated February 2, 1974, by which the Board and the Company Affairs Dept. of the Govt. of India declined to review the order dated December 31, 1973.

5. Perhaps all that a company could do at this stage was to deny that there were any circumstances justifying action u/s 237 in its case, for the Board does not take the company into confidence or indicate to it the basis for the action taken by it. It is, Therefore, of the greatest importance that when a company approaches the court with a writ petition, making out a prima face case that the action u/s 237 was not justified, the Board should place before the court all the circumstances available to it on the record on which the opinion has been formed that the persons in management were guilty of fraud, misfeasance or misconduct towards the company and its members. Unfortunately, in this case, the stand of the Board has been put forward piecemeal in its original counter-affidavit and two supplemental counter-affidavits filed by it, one before the hearing of the case started and the other at a considerably advanced stage of the hearing. The company has also filed more than one rejoinder. In order to understand the full facts, we have to consider the following seven affidavits, which we shall, for convenient reference, designate as A-1 to A-7 :

A-1. Reply affidavit of respondent dt. 31-7-75

A-2. Rejoinder of petitioner ,, 25-8-75

A-3. Further rejoinder ,, 28-10-76

A-4. Supplemental reply of respondent ,, 7-12-76

A-5. Further rejoinder of petitioner ,, 22-12-76

A-6. Further reply of respondent 13-1-78

A-7. Final reply of petitioner ? 24-1-78

6. The case against the company was first spelt out in A-1. In para. 10, it was stated that the order in the instant case had been passed on the basis of seven transactions of the company which had come to the notice of the Board :

1. Surrender of the sole selling agency of Jaipur Udyog Ltd.

2. Purchase and sale of the undertaking of Albion Plywood Ltd.
3. Sale of certain shares at a loss.
4. Investment in low yielding debentures.
5. Sale of jeeps at a loss.
6. Unsecured loan of large amounts to closely connected persons and
7. Write off of three loans.

7. As a general preface to these charges it was stated that the company was one of twelve companies that belong to a group known as the Sahu Jain group and it was a common tendency of common block shareholders of such group concerns to benefit each other even if at the cost of the other share holders. We have to examine by taking up each of these "charges" seriatim and analysing the averments of the parties, whether circumstances have been made out to sustain the action taken by the Board. General charge

According to A-1, the petitioner belongs to a group of companies known as "Sahu Jain group". It is stated that, according to the report of the Monopolies Enquiry Commission, 1965, a group of 26 companies has been said to belong to this business house and that, according to the report of the Industrial Licensing Policy Enquiry Committee, 1969, there were 29 such concerns. The respondent has referred to 12 concerns which are mentioned in both the reports and alleged that they belong to the Sahu Jain group. These concerns are, besides the petitioner (AML), Albion Plywood Ltd. (APL), Bharat Overseas Pvt. Ltd. (BOL), Hindustan Vehicles Ltd. (HVL), Jaipur Udyog Ltd. (JUL) Mahespur Holdings Ltd. (MHL), Parshya Properties Ltd. (PPL), Rohtas Industries Ltd. (RIL), Shree Kesaria Investments Ltd. (KIL), Shree Rishab Investments Ltd. (SRIL), New Central Jute Mills Co. Ltd. (NCJ) and Bharat Nidhi Ltd. (BNL). After setting out the names of these concerns, A-1 alleges "a common tendency of such shareholders/directors in these concerns to benefit each other even if at the cost of the other shareholders of the concern".

8. In reply to the above, the petitioner-company has stoutly repudiated the existence of any such group as alleged. It is stated that though a notice was given by the Dept. of Company Affairs in 1974, calling upon the petitioner to show cause why action u/s 48(2) of the Monopolies and Restrictive Trade Practices Act, 1969, should not be taken for default in compliance with the provisions of Section 26 of the said Act, the proceedings were dropped by a decision communicated on 26th April, 1976. In other words, the same Dept. of Company Affairs, had accepted the position that no case had been made out for treating these concerns as inter-connected.

9. Apart from the fact that the respondent has not answered the point made in the reply or given details to show that AML is one of the concerns belonging to a closely knit group along with the 11 others we are of opinion that this general

allegation made in A-1 is not helpful in determining the issues in the present case. Merely because certain companies are said to form a group and there are transactions between these companies, it cannot be presumed that the transactions are mala fide or that they were entered into with a view to defraud or otherwise act in a manner detrimental to some or all of the concerns. No doubt, in considering the nature of a particular transactions, or the purpose and motive behind it, the relationship between the parties may be a relevant consideration and while examining the seven specific charges made against the company, we shall keep this aspect also in mind to see whether there has been any attempt to act to the detriment of AML with a view to benefit any of the other concerns mentioned. But, all that we would like to observe here is, that the approach indicated in A-1, of starting with a presumption that there must be necessarily something wrong because the transactions are between companies of the same group, is not correct. The general charge formulated in A-1, Therefore, cannot, by itself, be a ground justifying the action u/s 237, in the present case, unless it is substantiated with reference to one or more of the other seven charges. Charge No. 3 : Sale of shares at a loss.

10. It will be convenient to take up the first two charges last. Taking up the third charge first, the complaint against the company is that between September, 1968, and February, 1970, it sold at a huge loss some of the shares held by it in NCJ, APL, HVL, MHL and KIL. The sale was at an unnecessarily low price (lower than the market price) and, in the case of two concerns, was of the controlling interest therein. So, it is alleged this transaction was " prima facie " against the interest of the company.

11. The factual position that emerges from the various affidavits in regard to these sales is as follows :

(a) In the case of NCJ, the shares were sold at rates varying from Rs. 4.40 to Rs. 4.50 per share as against the face value of Rs. 10. Though according to the respondents, NCJ had large reserves and had also earned good profits, it is admitted that the shares are quoted on the stock exchange and that the market quotations for the shares at the relevant time ranged between Rs. 4.56 to Rs. 4.62 per share. The claim of the petitioner-company is that the shares were sold at the rates quoted at the Calcutta Stock Exchange and this statement has not been denied by the respondent. Further, it is pointed out that even on the basis that they had been sold at rates slightly less than the market value, the transaction was still beneficial to the company inasmuch as the value of the shares fell from Rs. 4.50 this year to Rs. 3.75 in the subsequent year and, if the company had not sold the shares when it did, the loss would have been even greater.

(b) In the case of APL and HVL, it is common ground that these concerns had been incurring huge losses and that their shares were worthless. Forced to admit this position in A-4, the respondent would still find fault with the petitioner for having sold thirty-five thousand shares of HVL " for a nominal amount of Rs.

3,500 " alleging vaguely that this "conveys no sense except of getting the set-off against profits for the purpose of taxation ".

(c) In regard to the MHL and KIL, the shares are not quoted on the stock exchange. The allegations of the respondent that these were transfers of controlling interest is not correct. The number of shares sold were 23,000 out of 50,000, in the case of KIL, and 16,000 out of 35,000, in the case of MHL. There is no allegation that the petitioner had earlier transferred shares in these companies to the same person or associated person so as to give them controlling interest. Regarding the price, the complaint is that the shares were sold at Rs. 2.55 and Rs. 2.80, respectively, although the break-up value of the shares would have worked out to Rs. 15.71 and Rs. 11.58, respectively.

12. A study of the above facts would show that the charge that the petitioner had sold the shares at less than the market price is not borne out by the material on record. This is very clear in the case of the first three companies. In the case of the last two, no doubt, the sale price is less than the alleged break-up value. But in the case of a private limited company, the break-up value does not always or necessarily furnish a correct clue as to its market value at any particular point of time : [Commissioner of Wealth Tax Vs. Mahadeo Jalan and Mahabir Prasad Jalan and Others etc.,]. There is no other material to indicate that the actual" sale price did not represent the value which those shares could realise in the open market on the respective dates of sale though the companies whose shares were sold are said to belong to the Sahu Jain Group, that fact is of no significance as the sale does not benefit those concerns. Nor is there any allegation that these shares have been transferred to other companies of the same group at a favorable price to benefit them at the cost of the petitioner-company. In regard to this charge, Therefore, no circumstances have been shown to exist which could lead to the formation of an opinion that there has been some fraud, misfeasance or misconduct on the part of the management of the petitioner-company.

Charge No. 4 : Investment in low yielding debentures,

The purport of the charge against the company under this head is not clear. The allegation in A-1 is in the following terms :

" In June, 1970, the company purchased from Sri P. Jain, Smt. Indu Jain, Smt. Shushila Jain, the Bhartiya Gyanpit and the Universal Trust certain debentures worth Rs. 10 lakhs yielding 8% per annum, whereas the loans of the company yielded 11% per annum. "

13. The above allegation can mean one of two things. The first is that, whereas certain other investments made by the company by way of loans yielded an interest rate of 11% per annum, the debentures in question yielded only 8%. But if this were the charge against the company, that would not be sufficient to attract action under s, 237. All the funds held by the company cannot be invested so as to yield the same return. Merely because on some investments by

way of loans, the petitioner has been able to get 11% interest, the inference does not follow that an investment in debentures yielding 8% must be the result of some fraud, misfeasance or misconduct on the part of the directors. There is no material to suggest that all the investments of the company were yielding 11% interest and despite similar investments being available readily, the petitioner-company purchased these " low rate " debentures to oblige the vendors. It is also not alleged that funds yielding higher return were withdrawn for making these purchases to the detriment of the company.

14. The other possible interpretation of the allegation is that, whereas the company had received advances and deposits and paid interest thereon at 11%, it has invested the funds drawn from those advances and deposits in debentures which yielded a smaller return. This contention is met by A-2 which points out the fallacy in the above line of reasoning. There is no material to correlate the funds invested by the company in the above debentures with the loans taken by it on payment of interest at 11%. The resources of the company were not limited only to such loans. The company had received advances from its customers on which it paid no interest whatever. It has security deposits on which it was paying interest at only 6 to 6 1/2%. The surplus funds of the company had to be invested and there is no material to suggest that the investment in these debentures was in any way motivated. In fact, the charge does not even allege that the purchases were made to benefit the vendors who, it would appear, may be connected with the directors of the petitioner-company. In these circumstances, Therefore, no circumstances have been brought to light for drawing an inference of fraud, misfeasance or misconduct.

15. For the first time, in the reply affidavit, A-4, the respondent took a fresh point that the debentures purchased by the company were those of PPL which, in the year ended January 31, 1970, had incurred a net loss of Rs. 5.96 lakhs as against its paid up capital of Rs. 5 lakhs. It will be seen that this is a totally new charge. The original allegation against the company- was only for having made an investment yielding a smaller return and did not even mention the name of the company whose debentures were purchased. However, A-4 attaches importance to the name and seems to doubt the solvency of the company the debentures of which have been acquired, perhaps also because it is one of the concerns of the group according to the respondent. But this criticism has not been made out by reference to the balance-sheet position of the said company. As its name indicates it appears to be a property holding company. There is no information regarding its assets and liabilities. In the case of a property company it is not unusual that there are only losses in working in the initial stages of its development before the income from the properties constructed or held by it starts flowing in. Moreover, debentures are secured loans and there is not an iota of evidence placed to show that these debentures were worthless. The fact that PPL is a company of the group will not, per se, render the debentures worthless or the purchase motivated. A-4 has only attempted to voice a suspicion of bona fides but backed it by no material on record. Here also the respondent has failed

to make out the existence of circumstances to show that in purchasing these debentures, the directors of the company have been guilty of any fraud, misfeasance or misconduct towards the company or its members. Charge No. 5: Purchase and sale of jeeps.

16. The allegation is that in November, 1966 and January, 1967, the company purchased twelve jeeps. Seven of these were sold in March, 1967, and two more in October, 1967. The company incurred a loss of Rs. 47,000 on the purchase and sale. The jeeps had been insured only from January to August, 1967. The accounts of the petitioner did not show any expenses in respect of petrol during the year 1967. From these facts, the inference is sought to be drawn that the purchase of the jeep was not for the purposes of the business of the company and that the transactions were not in the interests of the petitioner-company.

17. The company's plea is that the jeeps were purchased and sold under the authority of resolutions passed by the board of directors. The transaction was in the ordinary course of business of the company and in order to ensure its smooth running. Though the exact manner of utilisation of these jeeps had not been indicated in the affidavits, Sri Sen submitted that the transaction should be judged in the light of the fact that it was put through at the time of the general elections, that the jeeps were purchased in business interests, " in order to ensure the smooth running of the business of the company " and that no mala fides were involved in the transaction.

18. We are unable to see how this transaction can attract the impugned action by the respondent. As suggested by Sri Sen, there is an Explanation for the purchase of the jeeps and their disposal within a short time. But, even disbelieving this Explanation and assuming the worst, it is a mere instance of purchase and sale by the company of a certain asset which resulted in a loss to the company. It has not been explained in what manner this transaction reveals fraud, misfeasance or misconduct on the part of the persons concerned in the management of the company. There is no allegation that these jeeps were intended for or utilized by those persons or that they were sold to them or to other concerns of this group in which they were interested at concessional rates or the like, Except that the company had entered into an imprudent transaction, there are no circumstances of the nature outlined in Section 237(b)(ii). Charge No. 6 : Loans to certain individuals

19. The respondent has taken objection to the advances of loans by the petitioner-company to a number of persons " who belonged to the Sahu Jain group " to the extent of Rs. 1"26 crores. In particular, it is stated that loans to the extent of Rs. 68.75 lakhs were advanced to one R.G, between August, 1968, and March, 1972, and that similar loans were also advanced to A.P.J. From these persons Rs. 20 lakhs and Rs. 9.5 lakhs, respectively, remained due to the petitioner. The answer of the company is that the petitioner had vast resources by way of deposits from stockists and advances from customers. The investment of these funds among others by way of loans was part of the business of the

company. These were loans carrying a high rate of interest (as admitted in para. 10(4) of A-1), and were repayable on demand. It has been denied that any loan in excess of Rs. 20 lakhs was given to R.G. In the case of A.P.J. only Rs. 4.45 lakhs was due and, in the case of R.G., the entire amount of the loan was repaid by 6th November, 1974.

20. The petitioner's reply that these are loans earning a high rate of interest has not been denied. In fact, one of the earlier charges against the company was that when these loans were earning a higher rate of interest of 11%, the debentures of P.P.L. carrying 8% interest should not have been acquired. It is, Therefore, inconsistent on the part of the Board to find fault with the company also for having advanced these loans. It is not the respondent's suggestion that these persons were not capable of returning the loans or that the persons concerned in the management of the company stood to gain in some way as a result of these transactions. The loans have also been substantially repaid. In these circumstances, we fail to see how this transaction can attract action u/s 237(b)(ii).

Charge No. 7 : Write off of three loans

21. According to A-1, the petitioner-company had advanced in 1963-64, three loans, one, a sum of Rs. 50,000 to Sri K.L.M., two, Rs. 30,000 to Sri T.H.K. and three, Rs. 15,000 to Shri H.K.M. Neither these loans nor any interest thereon was recovered from these persons though the interest itself was quite substantial and amounted to as much as Rs. 46,553. No efforts were made to recover them and a major part has been written off.

22. The Explanation given by the company is that these were very respectable and prominent persons in public life. One of them was a counsel for the company and one of them held a high office in the State of Orissa. When they were in some financial difficulty, the company advanced certain loans to them. But the circumstances were such that the loans could not be repaid. It was embarrassing for the company to take legal proceedings against them. However, some efforts for recovery were made. In the case of Sri T.H.K., Rs. 25,000 were recovered and only Rs. 5,000 had to be written off. The other two, however, became bad debts and were written off in 1973.

23. All that the materials placed on record discloses is that the petitioner-company advanced certain loans which became irrecoverable and had to be written off. The persons to whom the monies were lent were not relatives or associates of the persons concerned in the management of the company. They were outsiders and influential people to whom the company, bona fide, though perhaps" imprudently, as events turned out later, advanced certain monies which had to be written off. We are unable to conceive how this transaction of the company can be made the basis of a charge of fraud, misfeasance or misconduct on the part of the directors, etc., towards the company or its members.

24. We shall now take up the first two charges which are the most important.

Shri Kataria, in particular, has placed considerable reliance on the first charge as sufficient by itself to warrant the action taken. As will be seen later, there is an inter-connection between the two transactions which may have to be considered together. We shall, however, set out the facts discussed in respect of each of these charges separately and then discuss the resultant position that emerges.

Charge No. 1: Surrender of sole selling agency of JUL

25. The allegation, as set out in A-1, was that the petitioner had been appointed the sole selling agents of JUL for the sale of cement for a period of five years from April 1, 1966. From this agency, the petitioner was deriving an annual return of about Rs. 8 to 10 lakhs. Notwithstanding this, the company surrendered the agency in favor of BOL, without receiving any compensation for the unexpired period of the agency. The transaction, Therefore, was said to be, prima facie, against the interests of the company.

26. On behalf of the petitioner, it was pointed out by A-2 that this allegation was based on two misconceptions. The first was that the agency was extremely profitable to the petitioner-company. This was not so factually. Though the gross commission from this agency in the accounting years which ended on August 31, 1966, August 31, 1967, and August 31, 1968, amounted to Rs. 9.2 lakhs, Rs. 10.8 lakhs and Rs. 8.10 lakhs, respectively, the net income of the company from this source, after deducting the expenditure incurred for earning the said income, came to only Rs. 1.95 lakhs for the first year and there were actually losses of Rs. 65,000 and Rs. 2.24 lakhs, respectively, for the succeeding two years. Full details of the computations on the basis of which these figures were arrived at were given in A-3. It was pointed out that the New Delhi office of the petitioner looked after this business and also the work of three regional offices at Chandigarh, Jaipur and Sawaimadhopur. The work for the cement agency at these places was considerable and involved the setting up of a number of establishments with sufficient personnel to handle the work efficiently. Though the company also dealt in certain other commodities such as sale of steel pipes, plywood, paper and rubber goods, the turnover of cement was the maximum. The turnover in the other commodities varied between 1 and 2 1/2 per cent. of the cement turnover. The company, Therefore, apportioned the total expenditure on the basis of turnover and deducted the same to arrive at the net figures referred to earlier. The second misconception of the respondent according to the petitioner, was that the petitioner was entitled to some compensation for the unexpired period of the agency but had voluntarily forgone the same. This was also not correct. u/s 294A(c) of the Companies Act, the agents were not entitled to compensation on resignation.

27. The respondent tried to meet the above case of the petitioner in its affidavits A-4 and A-6. The correctness of the computation of the expenditure deductible against the commission income was contested on the following grounds :

(a) The New Delhi office of the petitioner looked after the cement agency not merely of JUL but also of other brands of cement such as Rohtas, Portland and

Ashoka. The commission earned by the petitioner from JUL was 40% of the total commission earned by it in 1966-67, and 33% in 1967-68, The expenditure deductible against the commission received from JUL would, Therefore, be much less than what has been claimed by the company,

(b) The allocation of expenditure on the basis of turnover was not correct because cement was a commodity in short supply which did not require any special efforts for sale.

(c) The expenditure taken into account by the petitioner included the interest paid by the head office which should be excluded and if this is done the net commission figures would work out to Rs. 4.12 lakhs in 1966, Rs. 2.19 lakhs in 1967 and Rs. 0.22 lakhs in 1968.

(d) As a result of the surrender of the sole selling agency the petitioner-company's asset position was considerably affected. It has to call back a loan of Rs. 60 lakhs from NCI and also dispose of other investments of about Rs. 45 lakhs. Moreover, it had to meet liabilities to the extent of Rs. 268 lakhs relating to the business of the sole selling agency and in order to raise this amount it had to sell its plywood factory for Rs. 57 lakhs, sell debentures for the amount of Rs. 63 lakhs, make over loans due to it from 9 parties amounting to Rs. 43 lakhs and pay cash of Rs. 105 lakhs.

28. These points have been effectively met by the petitioner-company. Regarding (a) it has been pointed out that the agencies of Rohtas, Portland and Ashoka cements were not accounted for in the New Delhi books of the company but were accounted for in the Calcutta books of the company. The expenditure pertaining to those agencies was, Therefore, not included in the New Delhi books. The Delhi office was having only the sale of paper, asbestos and certain other commodities in addition to the sole selling agency of JUL. It is, Therefore, not correct to say that only a part of the commission accounted for in the Delhi books was attributable to the JUL agency. This contention is also borne out by the copy of account of the New Delhi office placed on record by the petitioner. The first point made by the respondent is, Therefore, without force. Regarding (b) there is merely an assertion on behalf of the respondent that the sale of cement was very easy and did not call for any expenditure on the part of the company. In A-3, the petitioner-company has set out at very great length the nature of the activities and functions it had to undertake in relation to the business of the sole selling agency. A detailed analysis of the expenditure under various heads was also furnished. In the face of all these details, the mere assertion that the cement sold itself and that all the expenditure was unnecessary cannot be accepted. Point (a) made on behalf of the respondent again has not been substantiated. The interest paid by the company was interest paid by it on the advances it had received from stockists and purchasers of cement. The interest is, Therefore, expenditure properly debitable against the commission income and there is no justification for excluding the same from the P. & L. account. Regarding the other plea that interest received by the head office has not been taken into account,

the respondent has not placed before us the details of interest earned by the petitioner in relation to the sole selling agency, which, according to it, should have been included but has been left out of the account by the petitioner. Apart from the above lack of material we may also point out that even if, as contended by the respondent the expenditure by way of interest is left out of account, the net profit earned from the sole selling agency would be Rs. 4.12 lakhs in 1966, Rs. 2.19 lakhs in 1967 and Rs. 22,000 in 1968. In other words, it was a dwindling income and the mere fact of surrender of such a source of income cannot lead to the adverse inference sought to be drawn by the respondent.

29. Coming now to the points made out in A-6, we find again that the company has given a satisfactory reply. So far as the recall of a sum of Rs. 60 lakhs from the NCJ is concerned, it is pointed out that the petitioner-company had advanced Rs. 1,40,00,000 to the NCJ. The Company Law Board had directed the company to recall the loan in terms of Section 370 of the Companies Act. Actually, the company applied for extension of time for the recalling of the above amounts and it was only in pursuance of the directions of the Company Law Board, dated September 25, 1968, that the sum of Rs. 60 lakhs was repaid by the NCJ. This point, Therefore, is of no significance. As to the last point made regarding the sale of the company's assets, we may point out that the respondent is confusing between the result of the surrender of the sole selling agency and the cause therefore. Naturally, when the petitioner-company surrendered the sole selling agency, it had to repay the security amounts and advances received by it in its capacity as sole selling agents. This had necessarily to be done by disposing of some assets and by paying a certain amount of cash. It could also be that some of these assets may have been acquired out of the moneys received in the course of the sole selling agency. From the mere fact that, as a result of the transfer of the sole selling agency, the petitioner had to discharge its liabilities incurred in relation thereto by the disposal of certain assets and transfer of certain loans and payment of cash, it cannot follow that the very act of the surrender of the managing agency was inspired by improper motives.

30. The essence of the case of the department was that the sole selling agency was a very valuable asset which no prudent businessman would give up. A point has also been sought to be made in para. 9 of A-6 that whereas 5,000 out of 15,000 shares of the petitioner-company are in the hands of nationalised banks, BOL is a private Ltd. Co., the profits earned by which go to certain individuals who are at the helm of affairs of the petitioner-company. In considering it to be a valuable asset, the respondent has gone by the figures of gross commission without allowing the deduction of any expenditure there against ;Even if the expenditure cannot be allowed to the extent claimed by the petitioner, some expenditure must be allowed and, even according to the respondent's figures, the income from this source was dwindling over the years. The respondent's allegation that BOL is an associated concern has been denied in A-2 and A-6 and no material to show any close connection or control has been placed on record. In A-3 and A-7, the petitioner has alleged that, early in 1968, JUL had indicated

to it that they wished to terminate its agency and appoint BOL as its agents and it was in this context that they had to surrender the agency. Sri Kataria objects to this allegation made at a late stage being taken into account. There is also nothing to show that the initiative for terminating the agency came from JUL. So, we shall leave it out of account. But even ignoring all these submissions of the petitioner and taking the respondent's case at its best, all that has been made out is that the petitioner-company gave up a sole selling agency which was remunerative. But will this alone be a ground for drawing an inference that the persons in management have been guilty of fraud, misfeasance or misconduct towards the company ? We think not, and this will become clearer if we bear in mind that this transaction of surrender of the sole selling agency in favor of BOL was simultaneous with another transaction of surrender of the sole undertaking of APL, which we are discussing below and consider these two transactions together. We shall, Therefore, proceed to discuss the second charge against. Charge No. 2: Purchase and sale of plywood factory

31. The APL was a losing concern. It had sustained losses to the tune of Rs. 52.72 lakhs between October 1, 1962, to March 31, 1966. The petitioner-company had advanced loans to APL to the extent of Rs. 40 lakhs, and on October 31, 1965, a sum of Rs. 41,91,561.64 was due to the petitioner on account of principal and interest from APL. According to the petitioner, there was no way of recovering this loan and so the petitioner ultimately decided to purchase the undertaking of APL and carry on the business in plywood on its own. This proposal was placed before a meeting of the shareholders of the company held on 21st March, 1966. The explanatory note attached to the notice of this general meeting contained the resolution of the company approving the commencement by it of a business in plywood which was necessary in terms of Section 149 of the Companies Act as amended by Act 31 of 1965. The block assets were taken over at a value fixed by a reputed firm of valuers and the other assets were taken over at book value. The petitioner-company worked the concern for a period of three years but it was not a very successful experiment. In the period of April 1, 1966, to August 31, 1968, during which the petitioner-company ran the business it had to incur a further loss of Rs. 38.94 lakhs. Eventually, Therefore, the company decided that it was not profitable to continue carrying on the business and it was decided to dispose of the same. It was about this time that the surrender of the selling agency of JUL by the petitioner-company in favor of BOL was also contemplated and it was decided that the undertaking of APL would also be transferred to BOL. This transaction was also placed before a meeting of the shareholders of the company held on the 28th September, 1968, and the undertaking was transferred to BOL w.e.f. 1st October, 1968.

32. According to the petitioner, the above undertaking was purchased at a cost of Rs. 77.17 lakhs and the sale price was Rs. 88.18 lakhs representing the book value of the various assets as on the date of the sale. If this is correct, there is nothing even prima facie wrong with the transaction. The respondent's

allegation, however, is that the undertaking was purchased not for Rs. 77.17 lakhs but for Rs. 88.65 lakhs and sold not for Rs. 88.18 lakhs but only for Rs. 57 lakhs. The discrepancy in the purchase price is due to the fact that, according to the respondent an interest amount of Rs. 3.49 lakhs recoverable from the APL had not been realised. This has been categorically denied by the petitioner and it has been asserted in A-7 that interest was duly recovered from APL. It is then alleged by the respondent that the valuation report on the basis of which the purchase was effected does not give any basis for the valuation and that an inspection report showed that it had made a profit of Rs. 11.40 lakhs in the bargain. The inspection report relied upon has not been placed before us. That apart, the valuation was got done by a reputed firm of valuers. If the valuation report did not give the details, it was open to the respondent to have found out the details from the said firm. It cannot be merely assumed that this valuation report was a made-up one and that it did not represent the proper value of the purchased undertaking and that the consideration paid by the petitioner-company must have been an exaggerated consideration.

33. While, on the one hand, the respondent criticises the purchase as having been made at an exaggerated price, allegations of a contrary nature are made in regard to the sale transaction of the undertaking in 1968. Here, it is alleged that the sale price was only Rs, 57 lakhs and not Rs. 78.18 lakhs as stated by the petitioner. This allegation has also been denied by the petitioner. The respondent has drawn the inference that the sale price was only Rs. 65 lakhs from the fact that certain liabilities of the petitioner-company to the extent of Rs. 268 lakhs which was transferred to BOL were adjusted in the following manner :

Rs.

Transfer of debentures 63 lakhs

Cash Paid 105 lakhs

Loan Transferred 43 lakhs

Price of plywood factory 57 lakhs

Total 268 lakhs

34. The petitioner has pointed out in A-7 that this proceeds on a misapprehension. The total sale price was Rs. 78.18 lakhs as explained in detail in the annexure filed along with A-2 but only a part of the sale price was adjusted against the sum of Rs. 268 lakhs. Again, the respondent alleges that the transfer of the undertaking at book values was not justified and that the unit must have been worth much more in October, 1968, than in April, 1966. This allegation again is totally unacceptable. When the petitioner-company wanted to take over the undertaking of APL, which had suffered serious losses, it was prepared to take over the same only after having the block assets valued by a reputed firm of valuers. Having taken over the undertaking, the petitioner conducted the business for a period of about two years during which it suffered a

heavy loss. It was, Therefore, decided to transfer the undertaking to BOL at book value. There is nothing suspicious about this and the respondent admits in A-4 that it is unable to attribute any motive for the petitioner not undertaking a revaluation of the block assets. Thus, the respondent has not been able to make out any satisfactory reason why the purchase and sale price as claimed by the petitioner should be disbelieved.

35. Realizing this, perhaps, the respondent in A-4 poses a question : Why did the company purchase a losing concern ? and concludes that this must have been effected in order to claim a loss for Income Tax purposes, by claiming a set-off of the losses in the business against its other profits. It will be seen that this allegation overlooks the fact that the concern was taken over in lieu of a debt is not denied ; it does not also help the respondent's case. Even assuming that the petitioner-company took over this losing concern merely in order to reduce its Income Tax burden, the transaction would not be one detrimental to the interests of the company because admittedly the transaction helped to reduce the tax liability of the company to the extent of about Rs. 20 lakhs. That apart, this is merely a vague and wild allegation made by the respondent in an effort to make out some charge against the company when the charge, as originally laid, cannot be established.

36. According to the petitioner-company, the purchase was for Rs. 77.17 lakhs and the sale for Rs. 88.18 lakhs. If this is so, there is no case at all for the respondent. But even assuming that the undertaking had been purchased for Rs. 80.65 lakhs and had been sold only for Rs. 57 lakhs, this would not lead to an inference of any misfeasance, misconduct or fraud on the part of the management, if looked at against the correct factual background. It should not be forgotten that this was an undertaking which had been sustaining losses right from the commencement. The total loss incurred by it was to the tune of about Rs. 92 lakhs. So, the mere fact that it was sold to BOL for a price smaller than the purchase price is not sufficient to draw an inference against the directors or the management of the company. Having regard to the continuous record of losses, the suggestion made in A-4 that the value of the undertaking in October, 1968, must have been considerably more than the value of the undertaking in April, 1966, is obviously absurd and without basis. We are, Therefore, unable to spell out from the circumstances of the transaction the conclusion sought to be drawn by the respondent.

37. Moreover, as we have mentioned earlier, an important circumstance that is relevant in assessing the real effect of the transactions which form the subject-matter of the first two charges against the company is that they are really connected transactions. Both of them took place simultaneously. In or about July, 1978, the company decided to surrender the sole selling agency of JUL and also decided to transfer the undertaking of APL to BOL. In fact, the transaction involved a number of other mutual arrangements and adjustments which have not been properly examined by the respondent. The petitioner has denied that

BOL is a part of the group, but granting that it was, still one would appreciate that the two transactions put together do not leave any room for any adverse inference. Let us assume, as contended by the respondent that the sole selling agency of JUL was a profitable one. Let us also assume that the undertaking of APL was a losing one and had been transferred to BOL at a price lower than the price for which the petitioner purchased it. All these facts put together could only amount to this that, as a result of certain understandings in July, 1968, the petitioner-company transferred to BOL a remunerative undertaking and also an admittedly losing concern. It cannot, Therefore, be postulated that the management of the petitioner-company had indulged in these transactions with a view to benefit BOL and its limited shareholders at the cost of the petitioner-company. It should not also be overlooked that the transaction relating to APL had, at both stages, been placed before and unanimously approved by the shareholders of the company. It has been pointed out in A-6 that a substantial proportion of the shares of the petitioner-company was held by nationalised banks and it cannot be assumed that they voted the proposals which were patently detrimental to the company's interests.

38. We have discussed at length all the materials placed before us by the parties and reached the conclusion that the action initiated by the respondent against the petitioner-company was not justified. Sri Kataria, for the respondent "submitted that, at least in regard to the first two charges, the respondent has shown the existence of some circumstances which called for further investigation. He submitted that if, after investigation, the charges were made out, the board would take other action but that, if the charges could not be substantiated, further proceedings would be dropped. So, according to him, it was not possible on the material for this court to say that even the appointment of an inspector to delve into these matters was not necessary or justified.

39. We think that the contention of Sri Kataria proceeds on a misconception of the true scope of Section 237(b). In *The Barium Chemicals Ltd. and Another Vs. The Company Law Board and Others*, , the affidavit of the Board disclosed that :

" In the conduct of the company there was delay, bungling and faulty planning of project entailing double expenditure, continuous losses resulting in sharp fall in prices of the company's shares and resignation of some of the directors on account of differences of opinion with the managing director."

40. On the question whether these facts could support an order u/s 237(b), Mudholkar J. (speaking for himself and Sarkar C.J.), observed (AIR headnote p. 296--see also 36 Comp Case at p. 692) :

" It cannot be said that from a huge loss incurred by a company and the working of the company in a disorganized and unbusinesslike way, the only conclusion possible was that it was due to lack of capability. It was reasonably conceivable that the result had been produced by fraud and other varieties of dishonesty or misfeasance. The order did not amount to a finding of fraud. It was to find out

what kind of wrong action has led to the company's ill fate that the powers under the section were given. The enquiry might have revealed that there was no fraud or other similar kind of malfeasance. It would be destroying the beneficial and effective use of the powers given by the section to say that the Board must first have showed that a fraud could clearly be said to have been committed. It was enough that the facts showed that it could be reasonably thought that the company's unfortunate position might have been caused by fraud and other species of dishonest action. "

41. Two other judges, however, did not agree with this view. Hidayatullah J. (as he then was), expressed himself as follows. (AIR head note--see also pp. 661, 662 of 36 Comp Cas):

" 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 of course implicit that the opinion must be an honest opinion. The next requirement is that " there are circumstances suggesting, etc." These words indicate that before the Central Government forms its opinion it must have before it circumstances suggesting certain inferences.....

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, postulates the absence of a general discretion to go on a fishing expedition to find evidence. No doubt 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. If the action is questioned on the ground that no circumstances leading to an inference of the kind contemplated by the section exists, the action might be exposed to interference unless the existence of the circumstances is made out... Since the existence of "circumstances" is a condition fundamental to the making of an opinion, the existence of the 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. "

42. Shelat J. had this to say (See pp. 689, 690 of 36 Comp Cas) :

" There must Therefore exist circumstances which in the opinion of the Authority suggest what has been set out in Sub-clauses (i), (ii) or (Hi). If it is shown that the circumstances do not exist or that they are such that it is impossible for any one to form an opinion there from suggestive of the aforesaid things, the opinion is challengeable on the ground of non-application of mind or perversity or on the ground that it was formed on collateral grounds and was beyond the scope of the statute.

Even assuming that the entire Clause (b) is subjective and that the clause does not necessitate disclosure of circumstances, the circumstances have in the present case been disclosed in the affidavits of the Chairman and the other

officials. Once they are disclosed, the court can consider whether they are relevant circumstances from which the Board could have formed the opinion that they were suggestive of the things set out in Clause (b)."

43. Bachawat J. expressed no views on this aspect of the case.

44. The scope of the section was, Therefore, again considered by the Supreme Court in *Rohtas Industries Vs. S.D. Agarwal and Others*, " to sort out the requirements " of the section. After a review of the several decisions cited before the court, Hegde J. (speaking for himself and Sikri J., as he then was), concluded thus (p. 800 of 39 Comp Cas) :

" Coming back to Section 237(b), in finding out its true scope, we have to bear in mind that that section is a part of the scheme referred to earlier and, Therefore, the said provision takes its colour from Sections 235 and 236. In finding out the legislative intent we cannot ignore the requirements of those sections. In interpreting Section 237(b) we cannot ignore the adverse" effect of the investigation on the company. Finally, we must also remember that the section in question is an inroad on the powers of the company to carry on its trade or business and thereby an infraction of the fundamental right guaranteed to its shareholders under article 19(1)(g) and its validity cannot be upheld unless it is considered that the power in question is a reasonable restriction in the interest of the general public. In fact the virus of that provision was upheld by a majority of the judges Constituting the Bench in *The Barium Chemicals Ltd. and Another Vs. The Company Law Board and Others*, , principally on the ground that the power conferred on the Central Government is not an arbitrary power and the same has to be exercised in accordance with the restraints imposed by law. For the reasons stated earlier, we agree with the conclusion reached by Hidayatullah and Shelat JJ. in *The Barium Chemicals Ltd. and Another Vs. The Company Law Board and Others*, , that the existence of circumstances suggesting that the company's business was being conducted as laid down in Sub-clause (1) or the persons mentioned in Sub-clause (2) were guilty of fraud or misfeasance or other misconduct towards the company or towards any of its members is a condition precedent for the Government to form the required opinion and if the existence of those conditions is challenged, the courts are entitled to examine whether those circumstances were existing when the order was made. In other words, the existence of the circumstances in question are open to judicial review though the opinion formed by the Government is not amenable to review by the courts. As held earlier, the required circumstances did not exist in this case."

45. Bachawat J, was of a different view. He observed (p. 803 of 39 Comp Cas):

" If it is established that there were no materials upon which the authority could form the requisite opinion the court may infer that the authority did not apply its mind to the relevant facts. The requisite opinion is then lacking and the condition precedent to the exercise of the power u/s 237(b) is not fulfilled. On this ground I interfered with the order u/s 237(b) in *The Barium Chemicals Ltd. and Another*

Vs. The Company Law Board and Others, The condition precedent to the exercise of power u/s 237(b) is the opinion of the Government and not the existence of the circumstances suggesting one or more of the specified matters. To hold that the factual existence of such matters is a condition precedent to the exercise of the power is to re-write the section. Section 237(b) must be interpreted in the light of its own language and subject-matter. We miss its real import if we begin by referring to the construction put by other judges on other statutes perhaps similar but not the same. The decisions are useful when they lay down principles of interpretation or give the meaning of words which have become terms of art "

but he agreed with the conclusion of the majority that, on facts, the order u/s 237(b) was not maintainable. In that case, the only allegation against the company on the basis of which the action u/s 237(b) was sought to be supported was that it had sold certain preference shares at their face value when they could have been converted into ordinary shares of Rs. 10 each which were then quoted at Rs. 15 in the stock market. Hegde J. observed (pp. 800, 801 of 39 Comp Cas) :

" The next question is whether any reasonable authority, much less an expert body like the Central Government, could have reasonably made the impugned order on the basis of the material before it. Admittedly, the only relevant material on the basis of which the impugned order can be said to have been made is the transaction of sale of preference shares of Albion Plywoods Ltd. At the time when the Government made the impugned order, it did not know the market quotation for the ordinary share of that company as on the date of the sale of those shares or immediately before that date. They did not care to find out that information. Hence there was no material before them showing that they were sold for inadequate consideration. If as is now proved that the market price of those shares on or about May 6, 1960, was only Rs. 11 per share then the transaction in question could not have afforded any basis for forming the opinion required by Section 237(b). If the market price of an ordinary share of that company on or about May 6, 1960, was only Rs. 11 it was quite reasonable for the directors to conclude that the price of the ordinary shares is likely to go down in view of the company's proposal to put on the market another 50,000 shares as a result of the conversion of the preference shares into ordinary shares. We do not think that any reasonable person, much less any expert body like the Government, on the material before it, could have jumped to the conclusion that there was any fraud involved in the sale of the shares in question. If the Government had any suspicion about that transaction it should have probed into the matter further before directing any investigation. We are convinced that the precipitate action taken by the Government was not called for nor could be justified on the basis of the material before it. The opinion formed by the Government was a wholly irrational opinion. The fact that one of the leading directors of the appellant-company was a suspect in the eye of the Government because of his antecedents, assuming without deciding, that the allegations against him are true, was not a relevant circumstance. That circumstance should

not have been allowed to cloud the opinion of the Government. The Government is charged with the responsibility to form a bona fide opinion on the basis of relevant material. The opinion formed in this case cannot be held to have been formed in accordance with law."

46. From the foregoing it will be seen that 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. In the present case, if at all, there is some content only in the first two charges. But even there the Board is not clear about the facts and looking at both the transactions together there are no circumstances brought to light from which any fraud, misfeasance or misconduct on the part of the management can be made out. As Shelat J. has pointed out in *The Barium Chemicals Ltd. and Another Vs. The Company Law Board and Others*, , these expressions envisage the following types of conduct (AIR head note):

" The term "fraud" connotes actual dishonesty and, however much the court may disapprove of a personal conduct it must consider whether he 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 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 other act."

47. In the present case, there is no basis for any allegation of fraud or misconduct. It cannot even be alleged that the management has entered into any of the transactions in the nature of a breach of trust or with a view to cause pecuniary loss to the company. We have, Therefore, no hesitation in concluding that no case for action u/s 237(b)(ii) has been made out.

48. Before parting with the case, we should like to point out one further feature in the present case. As pointed out by the Supreme Court, the circumstances justifying action u/s 237 should exist at the date of the order. In A-1, the respondent only set out a few broad allegations which were controverted by A-2 and A-3. The respondent then filed A-4 giving further details and figures and it is not clear why these were not furnished at the original stage itself. In the original petition, the company had specifically alleged that the earlier investigations by the Board, in particular by Sri Suraj Kapur, had yielded nothing adverse to the company. In the original reply filed by the respondent (paras. 6 and 7 of A-1) this was not controverted, rather there was an indefinite statement that the functions of the Registrar of Companies and Sri Suraj Kapur were limited and they were not required or entitled to make any complaints regarding fraud or misfeasance, admitting impliedly that the reports had contained no adverse

comments, etc. The additional facts mentioned in A-4 were more in the nature of pointing out of loopholes in the defense put forward in A-2 and A-3, than a positive case based on definite data. Sri Kataria, however, stated in court that full details regarding the allegations were available from the inspection report and that he would place the same before us. But eventually neither the inspection report nor the facts and details gathered by the inspector were placed before us. Instead, A-6 was filed. This no doubt refers to the report of Sri Kapur dated January 12, 1973, and to the discussions he had with the officers of the company. But A-6 which puts forward certain additional facts avoids stating specifically that these facts were based on the results of the inspection report and had been arrived at after due investigation and enquiries with the company. Even in A-6 the attempt made is only to raise a cloud of suspicion by referring to a number of facts and figures without any attempt at analysing them and making out clear factual charges against the company. The charges are vague and general and do not attempt to bring home to the directors or persons in management in general or any of them in particular any conduct of the nature contemplated by Section 237(b)(ii). As pointed out in the case of *The Barium Chemicals Ltd. and Another Vs. The Company Law Board and Others*, , an allegation that the company had entered into an unremunerative or imprudent transaction cannot suffice to attract Section 237. If the basis of the order u/s 237(b) was only the data furnished in A-1, the material was woefully inadequate to support the order. But even the additional facts furnished in A-4 and A-6 do not add much substance to the charges. We, Therefore, hold that the respondent has failed to make out the existence or circumstances justifying the formation of an opinion that there was fraud, misfeasance or misconduct on the part of the persons in management of the company towards the company or its members.

49. We, Therefore, make the rule absolute and quash the impugned orders marked annexs. C, G, H and I to the writ petition. The respondents are restrained from giving effect in any manner to the aforesaid orders against the petitioner-company.

The writ petition is allowed with costs.