

(1996) 11 MAD CK 0050

In the Madras High Court

Case No : O.S.A. No. 221 of 1996 and C.M.P. No's. 12234 and 12673 of 1996

Asoka Betelnut Co. Pvt. Ltd. and others

APPELLANT

Vs

M.K. Chandrakanth

RESPONDENT

Date of Decision : 07-11-1996

Acts Referred:

Companies Act, 1956 — Section 210, 397, 397(2), 398, 433

Citation : (1997) 88 CompCas 274 : (1997) 1 LW 616

Hon'ble Judges : P. Sathasivam, J; Abdul Hadi, J

Bench : Division Bench

Advocate : C. Harikrishnan and Meenakshisundaram, for the Appellant; V. Ramachandran and V.V. Lakshminarayanan, for the Respondent

Judgement

Abdul Hadi J.

1. This original side appeal by the three respondents in C.P. No. 65 of 1987 which was filed by the respondent herein under sections 397 and 398

of the Companies Act, 1956 (hereinafter referred to as "the Act"), is against the final order therein dated January 12, 1996, directing the first

appellant company to purchase the shares held by the respondent herein and his "wife and children" and to set off against that purchase price the

amounts "lawfully due" to the first appellant company from the respondent herein, after valuing the said shares by taking into account the paid-up

capital as on the date of the institution of the petition and the "present market value" of the assets owned by the said company less its liabilities as

on December 31, 1995.

2. Even though the said impugned order held that the allegations of mismanagement made against the appellants "have not been established" and

even though it also held that the conduct of the respondent herein towards the

abovesaid company is ""far from being praiseworthy"", (he having admittedly"" failed to pay to the company the value realised from the sales of stocks of the company and ""diverted the funds to his own unsuccessful business"")) and even though it also observed that while according to the respondent herein about Rs. 13 lakhs is due from him to the abovesaid company, according to the appellants, the dues exceed Rs. 40 lakhs ; the said order held that, despite the actions of the appellants being not illegal"", the effect of those actions is ""oppressive"" of the rights of the respondent herein. In view of this finding regarding oppression, it appears, the impugned order has given the above referred to direction u/s 397 of the Act, after relying on the decision in Needle Industries (India) Ltd. and Others Vs. Needle Industries Newey (India) Holding Ltd. and Others, , which dealt with the concept of oppression underlying in the said section 397 (while section 398 requires ""mismanagement"" for its application).

3. Regarding the above referred to ""oppression"", it concludes as follows in paragraph 37 :

the total exclusion of the petitioner (respondent herein) from the management ;
the increase in the share capital even when the business was not yielding any profits, and at a time when the respondents (appellants herein) were fully aware of the petitioner's incapacity to contribute further capital ;
the continuous losses of the company resulting in the denial of any benefit to the petitioner on his shareholding even while the respondents and members of their immediate family functioned as permanent directors, and enjoyed the perquisites, received remuneration and commissions from the company on its sales and purchases, by effecting such sales and purchases through firms owned by them, cumulatively, has resulted in the oppression of the petitioner's legal and proprietary rights as a shareholder in the company.

4. The impugned order also observes thus :

The fact that the company owns valuable urban land and commercial building - such value in view of the increasing prices being likely to be much more than the total liabilities of the company - is of little consolation to the petitioner at the present time.

5. The impugned order also observes as follows :

As regards the losses incurred, the explanation offered at para 52 of the second respondent's counter-affidavit is that the company cannot stunt its own growth by paying Income Tax without availing of benefits such as depreciation, investment allowance, development rebate, etc. In the light of that explanation, the financial position of the company is apparently much stronger than that indicated by the losses shown in the balance-sheets, and profits and loss accounts of the company.

6. In arriving at the abovesaid conclusions and giving the abovesaid directions, the learned trial judge, in the impugned order, has chosen to "lift the corporate veil" of the first appellant company, which no doubt is a private limited company which was originally a partnership, and has purported to apply the principles governing dissolution of partnership.

7. Learned counsel for the appellants made the following submissions :

8. Two of the above referred to three happenings mentioned in paragraph 37 of the impugned order as reasons for coming to the conclusion of

oppression are only events that happened subsequent to the filing of the company petition. In other words, the exclusion of the respondent herein

by his being removed from the directorship of the first appellant company was only on December 7, 1987, while the company petition was filed in

June, 1987. Likewise, the increase in share capital spoken to therein was only on October 30, 1990, and the move for such increase itself was

made only very much subsequent to the said C.P. and even though the respondent herein sought for stay of the said move by filing C.A. No. 1147

of 1990 in the company petition, it only got dismissed on October 29, 1990, and even the appeal filed by him thereon in O.S.A. No. 196 of 1990

was dismissed as infructuous and even though the Division Bench observed finally in the said original side appeal that in the abovesaid company

petition, the company judge may consider whether the abovesaid increase was a bona fide one, etc., "in the light of the attacks if made in that

regard by the appellant (respondent herein)", the respondent herein did not choose to amend his pleas in the company petition to include the said

attack in relation to the said increase in capital.

9. Even regarding the abovesaid "continuous losses" referred to in the above referred to paragraph 37 of the impugned order, learned counsel for

the appellant refers to the explanation offered in paragraph 52 of the second

appellant's counter-affidavit mentioned in the impugned order itself

(vide page 4 of this order) and also points out that the losses were also particularly due to the non-payment, by the respondent herein, of the above

referred to huge amounts due to the first appellant company, for which the company had also to file two suits against the respondent herein. (C.S.

No. 750 of 1988 and C.S. No. 745 of 1988 claiming a sum of Rs. 38.08 lakhs and Rs. 7.71 lakhs respectively).

10. Regarding the other reason found in the above referred to paragraph 37 of the impugned order, viz., that the appellants (actually appellants

Nos. 2 and 3) ""received remuneration and commissions from the company on its sales and purchases"", the submission is that there is absolutely no

evidence about any such receipt.

Lifting of the corporate veil"" is not at all called for in the present case. In this connection, learned counsel relied on the following observation of the

Supreme Court in Hind Overseas P. Ltd. v. Raghunathprasad Jhunhunwalla [1976] 46 Comp Cas 91 :

When more than one family or several friends and relations together form a company and there is no right as such agreed upon for active

participation of members who are sought to be excluded from management, the principles of dissolution of partnership cannot be liberally invoked.

Besides, it is only when shareholding is more or less equal and there is a case of complete deadlock in the company on account of lack of probity

in the management of the company and there is no hope or possibility of smooth and efficient continuance of the company as a commercial

concern, there may arise a case for winding up on the just and equitable ground"" (i.e., u/s 433(f) of the Companies Act).

11. In the light of the above observation, learned counsel for the appellants submits that there is no proof in the present case that the respondent

herein had ""a right as such agreed upon for his active participation in the management"" of the concern in question, that the shareholding between the

rival parties is also not more or less equal, that there is also no proof of complete deadlock in the company, and that there is also no proof that

there is no possibility of smooth and efficient continuance of the company as a commercial concern. In this connection, he also points out that as on

April 16, 1977, the total shares allotted by the company were about 4,003, in

which only 1,000 shares were held by the respondent, while the second appellant had another 1,000 shares and there were 15 others holding different numbers of shares. While section 398 of the Act has no application at all to the present case, since the learned trial judge himself has held that there is no mismanagement, even section 397 of the Act is not applicable since, inter alia, there is neither plea nor proof that section 397(2) (b) of the Act is satisfied. (The said provision says, "if, on any application under sub-section (1), the Company Law Board is of opinion - that to wind up the company would unfairly prejudice such member or members, but that otherwise the facts would justify the making of a winding-up order on the ground that it was just and equitable that the company should be wound up ; the Company Law Board may, with a view to bringing to an end the matters complained of, make such order as it thinks fit").

12. The next submission of learned counsel is that the company petition is a mala fide one, the respondent herein having not complied with the notice given to him by the company, pursuant to the resolution passed, demanding the above referred to huge sums due from him to the company with reference to which subsequently even suits had to be laid against him.

13. The last submission of learned counsel is that the direction actually given against the first appellant company is not at all legal since section 77 of the Act is not taken note of, and further, since the wife and children of the respondent herein were not at all parties to the company petition and the said direction is vague since it is not clear regarding the "amounts lawfully due to the company" and the "market value of the assets owned by the company", etc.

14. On the other hand, learned counsel for the respondent reiterated the reasonings of the learned trial judge. He also points out that the subsequent events like exclusion of the respondent herein and increase in the share capital can be taken note of even if there is no amendment of the company petition. He also emphasizes the fact of continuous loss of the company for long number of years. He points out what is stated in the impugned order, viz., that in 1984, the loss was Rs. 5.6 lakhs, in 1985, it was Rs. 11.8 lakhs and in 1986, it was Rs. 7.6 lakhs, that even after the institution of the company petition, the company continued to incur losses, that

in 1992, the loss was Rs. 4 lakhs and for the year ended March 31, 1993, it was Rs. 3.6 lakhs and that on March 31, 1993, the accumulated loss was Rs. 94 lakhs odd. However, according to him, as against the value of the shares held by the respondents, the amount due by the respondent to the company is not a big sum. In the circumstances, according to him, there is no mala fides, in having filed the company petition. According to him, these have resulted in oppression. He also submits that section 397(2)(b) - requirement could be taken as satisfied in the present case, taking into account the facts of this case even though there is no specific finding to that effect by the learned trial judge. Lastly, he submits that regarding the direction given by the learned trial judge if it is in any way vague or unworkable, the relief could be moulded and a suitable direction could be given.

15. We have considered the rival submissions. It is quite clear to us that the arguments advanced by learned counsel for the appellants are weighty arguments and we are not satisfied with the submissions made by learned counsel for the respondent. One very important factor to be noted is that despite several serious allegations in the company petition, for many of them, there is no evidence at all. First of all, it must be noted that despite those allegations, which have been denied in the counter - (the impugned order itself says thus - "the respondents have denied all allegations made against them") - the petitioner in the company petition, has not chosen to enter into the witness box at all, nor any other witness or any document speaks about many of the abovesaid allegations made in the petition. Just to illustrate, for the following allegations made in the petition, even according to learned counsel for the respondent herein, there is no evidence :

(i) Appellants Nos. 2 and 3 started to carry on business in their own way without consulting the petitioner and ignoring his rights to participate in the affairs of the company. (vide paragraph 10 of the petition) ;

(ii) The second and third appellants "utilised the funds of the company in a manner prejudicial to the petitioner and the company and used to purchase articles for their own use and their relatives and used to debit in the company account by way of advertisement and entertainment expenses. They used to transfer the goods vehicles belonging to the company for a low price to their own nominees without even informing the

petitioner, though there was no need to sell the vehicles which were in good condition." (vide paragraph 14 of the petition) ;

(iii) The second and third appellants "have been exclusively enjoying the commission amounts by way of sales and purchases for their own benefits

through their private concerns . . ." (vide paragraph 15 of the petition) ;

(iv) The loss is due to the mismanagement of the business and manipulation of accounts. (vide paragraph 18 of the petition). (Actually, as already

indicated, the learned trial judge himself has held that there is no mismanagement) ;

(v) The petitioner "entrusted his personal accounts and cheque books along with the books of his family to the care and custody of the second

respondent for effective management of his affairs." (vide paragraph 9 of the petition).

16. In the light of the above extracted observations of the Supreme Court in Hind Overseas P. Ltd. v. Raghunathprasad Jhunjhunwalla [1976] 46

Comp Cas 91, there is no scope at all for invoking the principle of lifting the corporate veil in the present case, since none of the requirements

pointed out in the above referred to observations have been proved in the present case as rightly pointed out by learned counsel for the appellants,

as already indicated. We fully agree with the argument of learned counsel for the appellants in this regard, and we are unable to agree with the

reasoning of the learned trial judge in this regard. The learned trial judge has not considered this question in the light of the above referred to

weighty observations of the Supreme Court. Even if lifting of the veil is resorted to, we find, there are also several shareholders other than the

parties herein, so in their absence, no direction can normally be given.

17. No doubt, in regard to lifting of the veil, learned counsel for the respondent very much relies on Synchron Machine Tools P. Ltd. and others

Vs. U.M. Suresh Rao, . But, in our view, that decision has no application to the present facts. No doubt in that case in a petition u/s 397 of the

Act, the Karnataka High Court observed that the court might make an appropriate order providing for the exit of one of the groups to enable the

company to run smoothly, if such an order is just and equitable in the circumstances of the case. No doubt, that was also a case of a private

company. No doubt further, the principle of special relationship, as in the case of

partnership converted into private limited companies, was held to be attracted to the facts of the said case, but on the facts, the Karnataka High Court found in that case that if the company could continue to function smoothly only by exit of one group of shareholders, the court might order accordingly. But, in the present case, there is no such finding, nor is there even a plea or proof to that effect. Further, in that Karnataka case it was also found that if the affairs of the company therein were left to be controlled by two of the groups involved therein alone, deadlock in its affairs was bound to result. There is no such finding of deadlock in the present case.

18. It is also clear to us that there is neither plea nor proof regarding the requirement prescribed in section 397(2)(b) of the Act. In fact, the learned trial judge has also not given any finding in this regard. Therefore, section 397 of the Act also cannot be invoked in the present case. (Even according to the finding of the learned trial judge, section 398 of the Act cannot be invoked). It must also be noted that regarding the requirements of section 397 or section 398, there must be specific pleas by the petitioner. The Supreme Court has also held in the above referred to *Hind Overseas P. Ltd. v. Raghunathprasad Jhunjhunwalla* [1976] 46 Comp Cas 91, itself that in an application for winding up of the company under the just and equitable clause, allegations in the petition are of primary importance. The same observation will apply even to the present company petition.

19. In many decisions, it has been held that both conditions in clause (a) or clause (b) of sub-section (2) of section 397 must exist before the court can entertain an application under that section. Where there are no allegations followed by proof therefore to support a winding up, such a petition cannot be entertained. Further, it must also be proved that an order of winding up should not be made as it will unfairly prejudice the petitioner and other members. (vide (i) *Rattan Singh and Others Vs. Managing Director of the Moga Transport Company, Moga and Another*, relying on *Rajahmundry Electric Supply Corporation Ltd. Vs. A. Nageswara Rao and Others*, , and (ii) *Nagavarapu Krishna Prasad and Another Vs. Andhra Bank Ltd.*, . Further, the Supreme Court has also observed in *Needle Industries (India) Ltd. v. Needle Industries Newey (India) Holding*

Ltd. [1981] 51 Comp Cas 743 thus :

In an application u/s 210 of the English Companies Act, as u/s 397 of our Companies Act, before granting relief the court has to satisfy itself that

to wind up the company will unfairly prejudice the members complaining of oppression, but that otherwise the facts will justify the making of a

winding-up order on the ground that it is just and equitable that the company should be wound up.

20. As already indicated there are very many allegations in the petition for which there is no evidence at all. Further, though many such irregularities

against the appellants have been alleged to be in existence for several years, there appears to be no written protest against those irregularities. In

this connection, initially, learned counsel for the respondent represented that there was only oral protest. But, even regarding each oral protest,

there is no evidence. Subsequently, no doubt at a later stage, learned counsel for the respondent sought to rely on a letter by the respondent

addressed to the first appellant company on January 17, 1987, to contend that it was a written protest regarding one of the said irregularities. But,

on going through the said letter, we are unable to make out any such irregularity being alleged therein. If at all it only says that the appellants are

answerable to the respondents ""towards expenditures from the company towards your personal and family affairs, apart from the company"s

expenditure.

21. No doubt the company has suffered continuous losses, which has also been admitted by the appellants. But that by itself cannot lead to

oppression spoken to u/s 397 of the Act, particularly in the light of the above referred to explanation offered by the appellants, which was adverted

to in the impugned order in para (2) above. It has also been held that failure to declare dividends does not amount to oppression and mere

dissatisfaction of the minority does not justify interference by court (vide V.J. Thomas Vettom v. Kuttanad Rubber Co. Ltd. [1984] 56 Comp Cas

284 (Ker)).

22. Further, the above referred to increase in capital and the exclusion of the respondent herein are only subsequent events and, despite the above

said observation of the Bench in O.S.A. No. 196 of 1990 extracted in [See pages 277H and 278A-C.] para 4(a) and particularly, the last

sentence thereof, using the expression ""if made"", the said factors cannot be taken note of in considering the company petition, when there is no amendment made to the company petition by the respondent herein subsequent to the above referred to observation of the Division Bench in the said original side appeal.

23. It has also been held in *Kalinga Tubes Ltd. v. Shanti Prasad Jain* [1964] 1 CLJ 117 (Ori) (which has also been approved in *In Re: Bengal*

Luxmi Cotton Mills Ltd.,) that facts arising subsequent to the filing of the petition cannot be relied upon and that the validity of the company

petition will be judged on the facts alleged therein and existing at the time of presentation of the petition. It has also been held in the said decision

and the abovesaid Supreme Court decision that subsequent affidavits are not enough. Learned counsel for the respondent sought to derive support

from the averments made in one such subsequent affidavit, which was filed in 1990, in support of the above referred to Company Application No.

1147 of 1990. But, the petitioner should have amended the original company petition. Admittedly, that has not been done. That apart even with

reference to the averments in the above referred to affidavit in support of Company Application No. 1147 of 1990, it must be stated that the

counter-affidavit filed therein by the second respondent denies all the allegations in the affidavit in support of the said company application. When

there are such denials coupled with the fact that there was no oral evidence in the case and the fact that there is no other documentary evidence

also to prove the averments in the above referred to supporting affidavit in C.A. No. 1147 of 1990, there is no scope at all for invoking section

397 of the Act even on the basis of the averments in the above referred to supporting affidavit to the said company application. No doubt in the

said supporting affidavit, at paragraph 14, regarding the abovesaid increase in the share capital, it is said that the object of issuing additional share

capital is not bona fide and is only with the sole object of reducing the respondent's position in the company for the personal aggrandisement of

appellants Nos. 2 and 3 to the detriment of the company. But, there is no proof for these allegations. Unless there is proof for these allegations as

per *Needle Industries (India) Ltd. v. Needle Industries Newey (India) Holding Ltd.* [1981] 51 Comp Cas 743, increase in capital cannot be

considered as oppression.

24. Once it is clear that section 397 or 398 of the Act cannot be invoked, the direction given by the learned trial judge cannot stand. Even

otherwise, the said direction is in more than one respect not a lawful one as pointed out by learned counsel for the appellant in [See pages 279H

and 280A.] para 4(g) above. It is also vague as pointed out by the same learned counsel.

25. In the view we have taken, there is no necessity to deal with the contention relating to mala fides.

26. In the result, this original side appeal is allowed, the impugned order is set aside and the company petition shall stand dismissed. However, in

the circumstances of the case, there will be no order as to costs. C.M.P. Nos. 12234 and 12673 of 1996 are consequently dismissed.