

**(2000) 08 DEL CK 0140**

**In the Delhi High Court**

**Case No :** Civil Writ Petition No. 3141 of 1999

Basant Ram and Sons and Anrs.

APPELLANT

Vs

Union of India and Others

RESPONDENT

**Date of Decision :** 25-08-2000

**Acts Referred:**

Companies Act, 1956 — Section 224(7)  
Constitution of India, 1950 — Article 226

**Citation :** (2002) 110 CompCas 38 : (2000) 56 DRJ 491

**Hon'ble Judges :** Manmohan Sarin, J

**Bench :** Single Bench

**Advocate :** Mr. Navin Chawla, for the Appellant; Mr. Rajiv Sawhney, Senior Advocate, Mr. Rakesh Tikku and Mr. Sanjiv Anand, for the Respondent

## Judgement

Manmohan Sarin, J.—Rule.

Petitioners by this writ petition have assailed the order of the Central Government dated 12.4.1999, granting the approval u/s 224(7) of the Companies Act, 1956 (hereinafter referred to as the "Act") for removal of the statutory auditor, viz. petitioner No.1.

2. Learned counsel for the petitioner, Mr. Navin Chawla, has assailed the impugned order as being based upon irrelevant and extraneous considerations. He submits that the Central Government has given the approval in a mechanical manner and by relying on assertions and matters, which were not mentioned in the application for removal of the auditors. Further, that the impugned order was vitiated by noncompliance with the statutory provision u/s 224(7) of the Act.

It is submitted that as per the statute, the previous sanction of the Central Government is required to the proposal, for removal of the statutory auditors, before expiry of their term, being considered in the General Body Meeting. In the instant case, the proposal had been put up in the Extraordinary General Body Meeting, by which the Resolution dated 5.12.1998 was passed, without obtaining

the previous sanction of the Central Government.

3. Before dealing with the specific submissions made by Mr. Navin Chawla, learned counsel for the petitioners, it would be appropriate to recapitulate the relevant facts, in brief, leading to the filing of this writ petition.

(i) Respondent No. 3, M/s. Gangeshwar Limited, incorporated in 1932, was being managed by the Sawhney family since inception. Petitioner No.1, being a firm of Chartered Accountants were appointed the statutory auditors in the year 1932 for the first time. Petitioners since then were being reappointed every year. There was a family partition in the year 1972, and Mr. P.C. Sawhney acquired management and control of respondent No. 3, while the other brother, Mr. D.C. Sawhney, acquired management and control of Triveni Engineering Works Ltd. Eventually, in 1992, Mr. Dhruv Sawhney, son of Mr. P.C. Sawhney, acquired majority shares and control of Triveni Engineering Works Ltd. on retirement of Mr. D.C. Sawhney.

(ii) Respondent No. 3, M/s. Gangeshwar Ltd. faced severe financial losses and Mr. P.C. Sawhney thereafter transferred control and management to Mr. Dhruv Sawhney, after resigning as Chairman. Mr. Dhruv Sawhney was appointed, in September 1992, as the Chairman Managing Director of the Company, with his nominees being appointed as other Directors.

(iii) Petitioner No.1 claim that in the year 1993, while carrying out the audit of respondent No.3, they came across unauthorised and fraudulent transactions and reported the matter to the Secretary and other Directors of respondent No. 3, listing out the irregularities and requested for a reply so that appropriate reports could be prepared. Petitioner No.1 i.e. statutory auditors addressed a communication dated 10.7.1993 to the respondents. Petitioner No.1 claim that an audit committee was constituted by respondent No. 3 company, to investigate the issues raised by them. Petitioner No.1, year after year, approved the accounts with a statutory note that the same were approved pending enquiry by the audit committee. The audit committee, in its report, suggested adjustments. It is petitioner No.1's case that they were assured that specific answers to the queries raised by them would be subsequently given. On this assurance, they endorsed the report dated 19.2.1998 for the accounts ending 30.9.1997 by stating the factual position that recommendations of the audit committee had been accepted by the Directors and, as a result thereof, adjustments have been made in the accounts of respondent No.3. Petitioner No.1 claim that their specific queries remained unanswered.

(iv) In the meanwhile, the management of respondent No. 3 decided to merge, within it, the Triveni Engineering and Industries Ltd. (TEIL) in which Triveni Engineering Works Ltd., had amalgamated. Petitioner No.1 submit that their removal was sought on the ground that the Directors of the merging company, M/s. TEIL, wanted their statutory auditors to become the auditors of respondent No. 3. Petitioner No.1 claim that they were removed from office only because they

had started asking inconvenient questions to the Chairman of the Board. This led to the petitioner No.1 writing to the Managing Director about the funds of the company being siphoned off as also nonexplanation with regard to the queries that had been raised as far back as 10th September, 1993. Petitioner No.1 claim that the Chairman had initiated a note dated 28.10.1998, which was pushed through in the Extraordinry General Meeting held on 5.12.1998, for approving the removal of the petitioner No.1 as the statutory auditors. In the notice calling, the Extraordinary General Meeting on 5.12.1998, two reasons were mentioned for removal of the petitioner No.1 as statutory auditors, viz. (1) TEIL stipulating that their auditors should be appointed as statutory auditors of the company; and (2) that in the meeting held on 4.11.1998, the Board had formed an opinion that it would not be in the interest of the company that the petitioner No.1 be continued as statutory auditors and that they no longer inspired confidence.

(v) In the said meeting, a Resolution was passed, authorising the Board to make an application to the Central Government in terms of Section 224(7) of the Companies Act for granting its approval. Respondent No.3, in pursuance of the said Resolution, on 17.12.1998, applied to the Regional Director, Government of India, for granting of permission to remove the statutory auditors.

(vi) Petitioner, No. 1, by writ petition No. 1589/99, questioned the passing of the Resolution in the meeting without the consent of the Central Government. The said writ petition was dismissed as withdrawn on 18.9.1999, with liberty to raise all pleas before the Regional Director. Vide order dated 12.4.1999, the Regional Director granted its approval to remove the statutory auditors before expiry of their term subject, however, to further approval by the shareholders of the company in terms of Section 224(7) of the Act.

(vii) On the notice, convening the Extraordinary General Meeting for 5.12.1998 being issued, Mr. Jugal Kishore Chadha, brother of petitioner No. 1's senior partner, with another person filed suit bearing No. 2628/98, seeking a restraint on the holding of the meeting. The interim stay of the Extra Ordinary General Meeting was declined. The appeal before the Division Bench was also withdrawn. Another writ petition, viz. CW. 2570/99 was filed, questioning the validity of the order passed by the Regional Director and raising similar issues as raised in a suit bearing No. 2628/98. The said writ petition was dismissed on 28.4.1999. Petitioner filed the Letters Patent Appeal No. 188/99, challenging the dismissal of the writ petition. The said appeal was dismissed by the Division Bench, holding that there was no ground to interfere with the order passed by the learned Single Judge and it could only be challenged in case it becomes operative by passing of the Resolution of the Company. Petitioners filed Special Leave Petition, challenging the order passed in the Letters Patent Appeal. The said petition was also dismissed as withdrawn. Consequently, respondent No.3 company held its meeting on 12.5.1999, when the member were pleased to pass the Resolution for removal of the petitioners as their statutory auditor. The Resolutions were approved with 100% votes in its favor and M/s. J.C. Bhatia and Co. were

appointed as the statutory auditors in the Annual General Meeting held on 2.9.1999. The share holders present in person and proxy constituted 96% of the paidup capital.

(ix) It is in the background of the aforesaid facts that the present writ petition has been filed, challenging the order dated 12.4.1999, by the Central Government, granting its previous consent for approval by the shareholders in the meeting held on 2.5.1999. The statutory auditors appointed have audited the accounts of M/s. TEIL as merged with respondent No.3 as of 31.3.2000.

4. Learned counsel for the petitioner Mr. Navin Chawla in support of the writ petition submitted that the petitioners had been functioning as statutory auditors since 1952. He has submitted that there were serious allegations of misappropriation and defalcation and diversion of funds against the management. The respondents were finding the statutory auditors i.e. petitioner No.1 to be a thorn in their functioning and the propose merger. Therefore, they were sought to be removed Respondent Nos.1 and 2 have by their nonapplication of mind in passing the impugned order by relying on irrelevant and extraneous consideration granted the statutory approval for the same. He submits that the basic duty of the statutory auditors was to protect the interest of the company's shareholders and creditors, financial institutions and as such the permission for their removal should have been considered in this perspective. This the respondents failed to do. Learned counsel by way of illustration submitted that 40751 bags of sugar, with a value of over Rs. 3 crores were shown to be in stock, which were not found hypothecated and the sale consideration of the same was not accounted for. He submitted that a fake loading contract had been awarded to an employee involving disbursement of over Rs.30 lacs. He also submitted that the removal of the petitioner No.1 had been due to inconvenient questions being raised to protect interest of shareholders. He urged that simply the desire of the merging company to have its own auditors in place of the petitioner was no reason in law for removal of the petitioners. He submitted that the respondents have considered facts, which were not mentioned or included in the application seeking consent of respondent No. 2 for removal. Learned counsel also assailed the procedure adopted by respondent No. 3 in holding the Extra Ordinary General Meeting on 5.12.1998. He submitted that the resolution passed in the said meeting was in violation of the statute. There was failure to obtain prior approval as required u/s 227(4) of the Companies Act. Mr. Chawla urged that the entire process has been vitiated by the failure to obtain the previous consent of the Central Government, as provided in the statute prior to its approval in the Extra Ordinary General Meeting.

5. Mr. Rajiv Sawhney has also been heard at length, who recounted the events as reproduced in paras 1 to 4. Learned counsel justify the holding of the meeting on 5.12.1998, approving the resolution passed for seeking the approval of the Central Government for removal of the statutory auditors. There is considerable merit in this submission as there is no statutory bar on a prior meeting being

held, wherein the shareholders or the members approve the resolution for making of the application to seek the previous consent of the Central Government. The appointment of the statutory auditors u/s 224 of the Act is by the shareholders in the Annual General Meeting, till the next general meeting is held. The Board of Directors are not authorised to remove the statutory auditors prior to its expiry of term except under the procedure provided u/s 224(7) of the Act. In the instant case, pursuant to the resolution passed to submit the application for seeking approval of the Central Government for removal of the auditors, the application was submitted on 17.12.1998. The hearing was given by respondent No. 2 on 31.3.1999 and 12.4.1999. The impugned order granting the permission is again made subject to further approval of the members of respondent No. 3 company in terms of Section, 224(7) of the Act. The impugned order giving sanction for removal becomes operative only after the approval by the shareholders.

6. Learned counsel has pointed out that the shareholders in their meeting have approved the same with overwhelming majority of share holders" holding more than 95 per cent of the equity stock. There is no merit in the contention that simply because in the Extra Ordinary General Meeting on 5.12.1998, a resolution was passed authorising the Board to submit an application for obtaining sanction of the Central Government, the entire process or the impugned order gets vitiated. In the instant case, subsequent to the grant of permission, the shareholders have approved the same and objections in this regard, Therefore, must fail.

7. There is also considerable merit in the submission of respondent No.3 that the transactions, which are sought to be questioned and labelled as misappropriation and defalcation of funds and those which were mentioned in the letter dated 10.10.1993 of the statutory auditors, were prior to the present management of respondent No.3 taking over. The petitioners, who were the statutory auditors, had been the auditors all through. The present management and the Board of Directors, it is stated, on the other hand had taken note even prior to the letter of the statutory auditors of these transactions and had appointed an Audit Committee to go into the said issues.

8. Learned counsel for the respondent had in this regard laid considerable emphasis on the fact that the respondent Managing Director, Mr.Dhruv Sawhney, had been asked to take over the company when it was in the mist of an acute financial crisis. Operations had stopped. There was agitation among workers and the works were lying closed following the agitation and police firing. The officers of the company had been arrested, pursuant to the FIR lodged for failure to make the payment of the arrears of cane to farmers. The present management had retrieved the company from the brink of disaster, appointed an Audit Committee, which went into the transactions complained of. The Audit Committee after investigation recommended the adjustments in the entries, which were required to be made for the period 1991-93, 1995-96. The statutory

auditors had duly gone over the recommendations of the Audit Committee and after consideration of the entire matter, had closed the issue. This was in complete contrast with their letter dated 11.11.1998 when they sought to reagitate their issues. The statutory auditors had given an endorsement as under:

"We have been informed by the Board of Directors vide their letter dated 19th Feb,1998 that the Sub Committee called "Audit Committee" constituted by the Board of Directors to investigate into the various fraudulent and unauthorised transactions which were point out by us in our letter dated 10th September, 1993 has submitted its final report. In the said final report of the Committee, it has suggested writing off of recoverable to the extent of Rs. 8.28 lacs, making further provisions for Rs. 1.04 lacs, writing back certain payables aggregating to Rs.25.87 lacs and also adjustments of recoverables of Rs.190.67 lacs where relevant purchase documents were not available. The Board has accepted the recommendations of the Committee and consequently necessary adjustments have been made in the account under report."

9. In view of the foregoing observations of the petitioner statutory auditors, it is evident that the statutory auditors were satisfied with the Explanation and the action taken by respondent No. 3 pursuant to the Audit Committee's recommendation, as accepted by the Board of Directors. Learned counsel for the petitioner sought to urge that the above report/endorsement had been given on the petitioners being assured that answer to each of their query would be provided in due course. This plea does not inspire any confidence.

10. I find merit in the contention of the respondents that the statutory auditors had lost the confidence of the management. This is also apparent from the chequered history of the litigation that had ensued between the petitioners or by their associates at their behest. Year after year in the reports, the statutory auditors did not raise any objection but kept on making repeating the observation with regard to the matter being under investigation and had finally in their report of 11.2.1998 had accepted the recommendation. The petitioners raised this objection belatedly on 11.11.1998 after they had fallen foul with management and with a view to resist the action for their removal.

11. In these circumstances, I find that the impugned order passed was fully justified and in accordance with law. No ground is made out for interference in exercise of extra ordinary writ jurisdiction. The writ petition has no merit and is dismissed.