

(1999) 11 AP CK 0110

In the Andhra Pradesh High Court

Case No : O.S. Appeal No's. 5 of 1996 and 40 of 1999

C.N. Setty

APPELLANT

Vs

Hillock Hotels (P.) Ltd. and Others
 Hillock Hotels (P.)
Ltd. and Others Vs C.N. Setty

RESPONDENT

Date of Decision : 05-11-1999

Acts Referred:

Companies Act, 1956 — Section 397, 398, 402

Citation : (2000) 37 CLA 263 : (2001) 104 CompCas 722 : (2000) 1 CompLJ 181

Hon'ble Judges : P. Venkatarama Reddi, J;B. Prakash Rao, J

Bench : Division Bench

Advocate : Ravi S., in O.S.A. No. 5 of 1996 and Vedula Srinivas, in O.S.A. No. 40 of 1999, for the Appellant; Ravi S. in O.S.A. No. 40 of 1999 and Vedula Srinivas in O.S.A. No. 5 of 1996, for the Respondent

Judgement

P. Venkatarama Reddi, J. 1. O. S. A. No. 40 of 1999 is filed by the respondents in Company Petition No. 27 of 1988 (reported as C.N. Shetty v. Hillock Hotels Pvt. Ltd. [1996J 87 Comp Cas 1 (AP)) and O. S. A. No. 5 of 1996 is filed by the petitioner in the company petition. The respondents in the company petition (appellants in O. S. A. No. 40 of 1999) are aggrieved by the finding's of the learned judge that there was oppressive conduct on the part of the second respondent and his group of shareholders.

2. The petitioner in the company petition (appellant in O. S. A. No. 5 of 1996) hereinafter referred to as "the petitioner", is aggrieved by the quantum of relief granted by the learned single judge while allowing the company petition. It is the contention of the appellant in O. S. A. No. 5 of 1996 that the value of the shares which the respondents were called upon to pay to the appellant was very much on the low side and that option should have been given to the petitioner-appellant to buy shares.

3. C. P. No. 27 of 1988 was filed seeking directions under Sections 397 and 398 of the Companies Act, 1956, to provide relief to the petitioner against the alleged

acts of oppression. The petitioner sought an order to invalidate the issuance of additional shares to respondents Nos. 2 to 6 on March 24, 1988, to remove the second respondent and respondents Nos. 4 to 6 from the posts of managing director and directors respectively, to direct amendment of the articles of association so as to have proportionate representation for the petitioner on the one hand and respondents Nos. 2 and 3 on the other hand and lastly to allow the petitioner to purchase the shares of respondents Nos. 3 to 6 to the value fixed by this court. Respondents Nos. 3 to 6 are the wife and children of the second respondent.

4. The first respondent in the company petition is the company by name Hillock Hotels Private Limited, having its registered office at Vishakapatnam. The main object of the company is to carry on the business of hotel, restaurant, lodging-house keepers and to provide places of amusement, recreation, entertainment, etc.

5. The first respondent-company was incorporated initially on May 13, 1980, with an authorised share capital of Rs. 10 lakhs divided into 1,000 equity shares of Rs. 1,000 each. The subscribed and paid up share capital up to 1988 was Rs. 1,10,000 divided into 110 equity shares of Rs. 1,000 each. Respondents Nos. 2 and 3 (husband and wife) who had each subscribed for five shares were the subscribers to the memorandum and articles of association and they became the directors in terms of the articles. The second respondent was nominated as managing director in terms of Article 19. The petitioner was inducted as a director at the first meeting of the company held on June 7, 1980, i.e., one month after the formation of the company and five shares were allotted to him initially. On March 9, 1981, the petitioner was allotted 45 shares thereby making up the total of 50 shares of the face value of Rs. 50,000. At about the same time, respondents Nos. 2 and 3 were also allotted additional shares and they held 25 shares each. Thus, the shareholding of the petitioner and respondents Nos. 2 and 3 together was in equal proportion. Two other persons were also allotted shares of five each. On February 2, 1987, 150 additional shares were issued and those shares were allotted to respondents Nos. 4 to 6. Thus, respondents Nos. 2 to 6 acquired a substantial number of shares thereby disturbing the parity in the shareholding which the petitioner and the respondents Nos. 2 and 3 initially had. In 1992, i.e., during the pendency of the company petition, 250 additional shares were allotted to respondents Nos. 2 to 6 at 50 each.

6. The respondent-company purchased a plot of land of 1,300 square yards, in Vishakapatnam urban area for the value of Rs. 81,660 on July 29, 1980. At the meeting of the board of directors held on June 6, 1987, attended by respondent No. 2 and respondent No. 3 only, it was resolved to issue further shares for raising necessary funds for construction of a residential complex. On September 3, 1987, the managing director was requested to take necessary steps to receive the applications for shares in order to proceed with the construction activity.

Thus, admittedly, the additional share capital was raised for the purpose of constructing a multistoried residential complex which, it is not in dispute, is not covered by the objects of the company. When the construction was about to be started, the present company petition was filed.

7. The broad contention of the petitioner has been that the company promoted by the second respondent in association with the petitioner was more or less like a partnership venture with the fundamental postulate that there should be equal participation. But when the land value had gone up, the second respondent managed to allot additional shares to himself and his family members to gain control over the company to the detriment of the petitioner. The second respondent therefore betrayed the mutual confidence expected to be maintained. It is also contended that the second respondent without starting the hotel project, took steps to embark upon a totally different venture without the knowledge of the petitioner. These acts according to the petitioner, constituted oppression and, therefore, the various reliefs as mentioned supra were sought for.

8. The stand of the second respondent is that the decision taken by the board of directors to take up construction of a residential complex was bona fide and was in the general interest of the company. The petitioner was not taking any interest in the management of the company and was not even attending the meetings in spite of intimation. As finances were required for taking up the construction work, it was decided to raise additional share capital. The allegations of oppression or lack of probity and betrayal of confidence are denied. The second respondent also expressed his willingness to agree to allotment of additional shares now if the petitioner so desires.

9. The petitioner got examined as P.W.-I and the manager of the first respondent-company was examined on behalf of the respondents as R.W.-I.

10. The learned single judge framed five issues which are as follows (page 5 of 87, Comp Cas) :

"(1) Whether the respondent-company is in the nature of a joint venture partnership between the petitioner and the third respondent ?

(2) Whether the issue of additional share capital in March, 1988, suffers from any illegality and has been done by respondents for their exclusive benefit and is an act of oppression ?

(3) Whether the company has undertaken construction of residential flats and if so, is it within the scope and authority conferred by the memorandum of association ?

(4) Whether the affairs of the company are being conducted in a manner oppressive to the interests of the petitioner for the reasons mentioned in the petition ?

(5) What relief to be granted in this petition ?"

11. In a way, issues Nos. 2 to 4 are overlapping. Issues Nos. 1 to 4 are held in favour of the petitioner. As regards the fifth issue, the learned judge calculated the value of 50 shares held by the petitioner and directed respondents Nos. 2 to 6 to pay Rs. 2 lakhs and acquire his fifty shares and in default, the petitioner was permitted to move the court for appropriate directions for the purchase of shares of respondent No. 2 to respondent No. 6 by him.

12. We have our serious reservations in endorsing the findings reached by the learned judge vis-a-vis the first issue that the company in substance was a partnership. Except the fact that the shareholdings were equal at the initial stages of the company, there were only a few outsiders with insignificant share value and the intimate friendship may be an impelling motive to the petitioner to collaborate with the second respondent, prima facie, we are not inclined to think that the various criteria adverted to by the learned judge at page 11 of the judgment, are satisfied in the instant case. There is no evidence to the effect that the company was formed or continued on the basis of personal relationship involving mutual confidence, nor was there any evidence or pleading that there was an agreement--express or implied that the petitioner should actively and in equal measure participate in the business affairs of the company. However, we need not dwell on this aspect at length as we are inclined to concur with the learned single judge as regards the finding of oppression.

13. Learned counsel for the appellants in O. S. A. No. 40 of 1999 (respondents in the C. P.) assailed the observations and finding of the learned judge that there was no need to issue additional share capital for any purpose connected with the objects of the company and such a move on the part of the appellant and his group amounted to oppression. It is submitted by learned counsel for the appellants in O. S. A. No. 40 of 1999 that from the mere fact that the activity of building a residential complex did not fall within the scope of the enumerated objects of the company, the decision taken cannot by itself be construed as an act of oppression as it would ultimately benefit the general body of shareholders. It is pointed out that the memorandum of association could always be altered to take care of the legal requirement. It is further submitted that the petitioner took little or no interest till he nurtured the idea of gaining control over the company after its only asset, i.e., the plot of land, considerably appreciated in value. Learned counsel while contending" that in any case there were no continuous acts of oppression, called in aid the principle that an isolated act of oppression or lack of fairness is not a sufficient ground to grant relief u/s 397.

14. We are unable to agree with the contentions of learned counsel for the respondents in the company petition though plausible they are. It cannot be gainsaid that the move to raise additional share capital that too with a view to embark upon a venture not contemplated by the objects for which the company was incorporated is a very significant and crucial move. The definite case of the petitioner has been that he was not made aware of such move and had no knowledge that the meeting of the board of directors held in June and

September, 1987, was being convened for that purpose. The petitioner stated in his evidence that he was not invited to the board's meeting where the decision to issue additional shares was taken. The witness for the respondents--R.W.-1, admitted that at the time of increase of the capital in the year, 1987, no shares were offered to the petitioner. Even for the shares allotted during the pendency of the company petition, there is nothing to show that any offer was made to the petitioner. True, as pointed out by learned counsel for the petitioner, the learned single judge found that there was an admission of the petitioner that he was receiving intimations of meetings by telephone. On the basis of this so-called admission, the learned single judge skipped the discussion on the issue by observing that the question whether the petitioner was given notices cannot be decided as there was no adequate material one way or the other. But, we are of the view that the admission referred to supra cannot be stretched too far. It does not mean that the petitioner was having notice of crucial meeting's held on June 6, 1987, and September 3, 1987. It is not the case of the respondents that written intimation of the meeting and the agenda was sent to the petitioner in advance or at least the details of agenda were notified to the petitioner even orally. There is no good reason nor explanation for bypassing the prescribed procedure of sending the notices of meeting in advance that too when an important aspect having a great bearing on the future affairs of the company, was going to be discussed. The irresistible inference that needs to be drawn is that second respondent deliberately kept the petitioner in the dark about the proposed raising of share capital, that too, to finance a new line of business. The fact that the second respondent followed up the decision taken on September 3, 1987, by allotting the additional shares to his kith and kin without even apprising the petitioner of the decision, is a further pointer of his design to gain control over the company to the exclusion of the petitioner. The court has to take into account the overall picture emerging from the undisputed facts and the evidence on record. The least that can be said is that the petitioner who was having an equal stake in the company and was associated with the company from the beginning was given a raw deal when it came to the question of allotting the additional share capital. He was not put on due notice of the proposed allotment of additional shares, nor about the change of business activity. The arbitrary and unfair acts of the second respondent would undoubtedly tantamount to acts of oppression within the meaning of Section 397. The effect of such act is to be felt not just on one day or for some days, but it had continuing repercussions. In other words, the potential of oppression casts a shadow over the affairs of the company all the time to come.

15. We cannot but conclude that by issuing shares in favour of the family members of the second respondent without the knowledge of the petitioner, respondents Nos. 2 and 3 have forsaken the fiduciary position as directors and exercised their power for extraneous purposes with the predominant object of gaining control over the affairs of the company and for benefiting themselves and their children. It is true, as pointed out by the Supreme Court in *Needle*

Industries (India) Ltd. and Others Vs. Needle Industries Newey (India) Holding Ltd. and Others, , that the mere fact that by the issue of shares, the directors incidentally acquire control over the company, does not amount to abuse of their fiduciary power. But that is not the case here. The power has been exercised for extraneous reasons for the self-aggrandisement of respondent No. 2 and his family and such exercise of power is taboo as observed in that very decision.

16. We, therefore, agree with the finding of the learned single judge on issue No. 4 read with issues Nos. 2 and 3, though for somewhat different reasons. We, therefore, dismiss O. S. A. No. 40 of 1999 filed by the respondents in the company petition.

17. The next contentious issue is about the relief granted by the learned judge. As already noted, the appeal, O. S. A. No. 5 of 1996, filed by the petitioner in the company petition is directed against this part of the order. The learned judge having held that the affairs of the company were being conducted by the majority shareholders in a manner oppressive to the petitioner and that there were sufficient grounds to wind up the company came to the conclusion that winding up order will unfairly prejudice the petitioner and, therefore, thought it fit to grant relief u/s 402(b) of the Companies Act which enables the court to make an order for the purchase of the shares of any member of the company by other members thereof or by the company. As it is nobody's case that the company should be wound up, the learned judge rightly concentrated on the question on what terms the order should be passed u/s 402(b). The learned judge following the dicta of Lord Denning speaking for the House of Lords in *Scottish Co-operative Wholesale Society Ltd. v. Meyer* 1959 29 Comp Cas 1 and the guiding principle laid down in the case of *Bird Precision Bellows Ltd.*, In re 1985 3 All ER 523 took the view that the oppressor should be directed to buy the shares at a fair price and the value of such shares on the date of the petition should be the determining criterion.

18. The learned judge commented that the normal rule is that the oppressor has to buy the shares of the oppressed shareholders though in exceptional circumstances such as those obtaining in C. P. No. 8 of 1981 (decided by Jeevan Reddy J. on June 10, 1988), the oppressed shareholders could be directed to buy the shares of the oppressor. The view of the House of Lords in *Scottish Co-operative Wholesale Society Ltd. v. Meyer* 1959 29 Comp Cas 1 was followed by a Division Bench of Calcutta High Court in *Ramashankar Prosad and Others Vs. Sindri Iron Foundry (P) Ltd. and Others*, . In that case, an auditor was appointed to find out the value of the shares at the date of the petition and it was further directed that the respondents who were found to be oppressors should buy the shares of the petitioners. The said decision of the Calcutta High Court was cited with approval recently by a Division Bench of this court consisting of U. C. Banerjee C. J. (as he then was) and Bilal Nazki), in *R. Khemka and another Vs. Deccan Enterprises Pvt. Ltd., Secunderabad and others*, . The view taken by the learned single judge in the impugned judgment cannot, therefore, be said to be

erroneous. True, as pointed out by learned counsel for the petitioner (appellant in O. S. A. No. 5 of 1996), what was laid down by Lord Denning in Scottish Co-operative Wholesale Society's case 1959 29 Comp Cas 1 is not a hard and fast rule. Apart from the decision of Jeevan Reddy J. referred to by the learned single judge, our attention has been drawn to the observations of A. N. Sen J. in Tea Brokers Pvt. Ltd. v. Hemendra Prasad Barooah (Appeal No. 186 of 1971). It was observed therein that the decision of the House of Lords in Scottish Co-operative Wholesale Society's case 1959 29 Comp Cas 1 is not an authority for the proposition that whichever party comes to the court complaining of acts of oppression by the opposite party, the applicant party must always be directed to sell the shares to the party who commits the acts of oppression. We are also of the view that no such inflexible proposition can be laid down. Even then, we do not think that this is an exceptional case which calls for departure from the normal rule enunciated in Scottish Co-operative Wholesale Society's case 1959 29 Comp Cas 1. The deposition of P.W.-I referred to by the learned judge in the concluding part of the judgment makes it clear that the petitioner expressed his willingness at one point of time to withdraw the company petition if the respondents paid half of the land value. The second point to be taken note of is that the petitioner ought to blame himself partly for the situation in which he landed himself. He should have taken more interest in the affairs of the company and should have been more vigilant. This conduct of the petitioner disentitles him to the relief which he sought for, viz., that he should be allowed to purchase the shares of respondents Nos. 2 and 3.

19. The next aspect pertains to the mode of valuation. As already seen, the value that the share would fetch at the date of the petition was the criterion applied in Scottish Co-operative Wholesale Society's case 1959 29 Comp Cas 1 and reiterated in Ramashankar Prosad and Others Vs. Sindri Iron Foundry (P) Ltd. and Others, , which in turn was referred to with approval by the Division Bench of this court in R. Khemka's case 2000 100 Comp Cas 211. The learned judge, however, took the relevant date as the date on which the additional share capital was issued. The relevant date was, therefore, taken as December 1, 1987, for the purpose of estimation of the share value. Whether the date December 1, 1987, is taken as the relevant date or the date of filing of the petition, i.e., April 18, 1988, is taken as the relevant date, it does not make much of a difference. The time gap is only five months. In fact, the learned judge actually estimated the share value obtaining the year 1987-88.

20. The next question is about the valuation of shares. It is not in dispute that having regard to the fact that the only asset of this non-functioning company is the land and there are practically no liabilities, the share value could be related to the land value. The learned judge rightly observed that notwithstanding the book value of the land being Rs. 91,193 as per the latest balance-sheet, it is legitimate to take into account the market value of the land. To avoid further delay in this old matter, the learned judge did not deem it expedient to have the shares valued by a chartered accountant. The learned judge is quite right in

saying so. The value of the land of 1,361 square yards, was fixed at Rs. 8,02,990. On that basis, the value of 50 shares was computed at Rs. 3,64,950. Having arrived at that figure, the learned judge scaled it down to Rs. 2 lakhs and it is this amount of Rs. 2 lakhs that was directed to be paid by respondents Nos. 2 to 6. In scaling down the amount, the only reason given by the learned judge was that as per the deposition of P.W.-I, respondent No. 2 sent a word that he was willing to pay Rs. 2 lakhs, if he withdrew the company petition. But, P.W.-I insisted on half the value of the land to be paid. The learned judge then remarked that the actual value of the land as on December 1, 1987, was not mentioned in the deposition. The learned judge, without any further discussion, accepted the suggestion of learned counsel for the respondents that Rs. 2 lakhs can be taken as the reasonable amount. With respect, we do not find sufficient basis for reducing the value of Rs. 3.65 lakhs to Rs. 2 lakhs. The unfructified offer given by the second respondent cannot form the basis for valuing the land and the shares.

21. The learned judge took note of the fact that as per the version of R.W.-I himself, the company purchased another plot of land of an extent of 1,016 square yards, close to the land in question in March, 1992, at the rate of Rs. 787 per square yard. In order to arrive at the value in 1987-88, the learned judge made a proportionate reduction by applying the cost of inflation index notified by the Central Government for the purpose of computation of capital gains. Resultantly, the value of 1,361 square yards, at the date of filing the petition was fixed at Rs. 8,02,990. On that basis, the value of 50 shares was computed at Rs. 3,64,950. We find no good reason to depart from this value adopted by the learned judge.

22. However, as already observed, we disapprove the unwarranted reduction in the estimated share value. We are also of the view that the petitioner-appellant should legitimately get some thing more than this amount. The order of the learned single judge was passed in January, 1996. Having regard to the time lag and costs that would have been incurred by the petitioner in pursuing this protracted litigation, we consider it just and proper to fix the amount to be paid to the petitioner by respondents Nos. 2 to 6 at Rs. 4 lakhs instead of Rs. 2 lakhs. We may mention that in the course of arguments, learned counsel for the respondents stated that the respondents in order to avoid further litigation will be willing to pay Rs. 4 lakhs to the petitioner in full settlement. However, as there was no compromise on that basis, the case was again heard on the merits.

23. We, therefore, modify the order of the learned single judge by directing payment of Rs. 4 lakhs instead of Rs. 2 lakhs. The second respondent may deposit the amount in a bank with instructions to the banker to pay the amount to the petitioner (appellant in O. S. A. No. 5 of 1996) on the petitioner producing before the officer of the bank the share transfer forms and other documents necessary to effectuate the transfer of shares. The respondents shall deposit the same within a period of one month and send an intimation to the petitioner as

well as the petitioner's counsel by registered post. In case neither party fulfils the obligations following this order, it is open to the aggrieved party to seek further directions from the court.

24. In the result, O. S. A. No. 40 of 1999 is dismissed and O. S. A. No. 5 of 1996 is allowed to the extent indicated above. We make no order as to costs.