

(2007) 05 CAL CK 0010

In the Calcutta High Court

Case No : A.P.O. No. 70 of 2007 and A.C.O. No. 60 of 2007

Linkmen Services P. Ltd. and Others

APPELLANT

Vs

Tapas Sinha and Others

RESPONDENT

Date of Decision : 14-05-2007

Acts Referred:

Companies Act, 1956 — Section 10F, 397, 398

Citation : (2008) 141 CompCas 198 : (2008) 2 CompLJ 61 : (2008) 83 SCL 143

Hon'ble Judges : Sanjib Banerjee, J

Bench : Single Bench

Advocate : S.N. Mookherjee, S. Chowdhury, Pallab Kr. Chakraborty and Sandipan Mitra, for the Appellant; Anirudha Chatterjee, Sanjib Chakraborty and Rituparna Dey, for the Respondent

Judgement

Sanjib Banerjee, J.—The principal challenge in this appeal u/s 10F of the Companies Act from an order disposing of a petition under Sections 397 and 398 of the Act, is as to the finding that the articles of a company cannot empower it to forfeit shares on account of dues other than unpaid calls. The appellants assert that the view taken by the Company Law Board is clearly at variance with the law laid down by the Supreme Court in the judgment Naresh Chandra Sanyal Vs. Calcutta Stock Exchange Association Ltd., , which was cited before the Board.

The company is engaged in the business of distribution of satellite signals, as a master control room, to the cable television operators. Its members are the cable operators each of whom has a dual relationship with the company. Members of the company are also its only clients. Amid charges of mismanagement brought by the respondents, the amendment of two articles of the company and the forfeiture of their shares pursuant to the amended articles were cited as grounds of oppression. The subsequent re-allotment of the forfeited shares were also challenged by the respondents, though some of them acquired such forfeited shares.

2. Charges of defalcation and misappropriation of funds were brought against

those in management by some members. It is claimed in the petition before the Company Law Board, that as a retaliation those in management sought to amend the articles of the company to include oppressive provisions to arm themselves with the ammunition for silencing the complaining members by banishing them from the company altogether. The respondents in this appeal, some of whom had made a belated and failed attempt to carry their independent appeal from the same order on the ground that their charges of mismanagement were not adequately addressed, appear to have cited the amendments as grounds of oppression rather than challenge the same as to the legality thereof. After all, it is recognised that an illegal act may not per se be oppressive, but a perfectly legal act can be challenged as being oppressive. That is not to say that the illegality of an action cannot be tested in the proceedings u/s 397 or 398 of the Act, but only to emphasise that such provisions require a case of oppression or mismanagement to be made out which may or may not involve any overtly illegal conduct.

3. The appellants assail, on law, the finding of the Board that the provisions incorporated in the articles were alien to corporate jurisprudence and the ancillary conclusions of the Board that forfeiture of shares could only be for unpaid calls and that the forfeiture in this case was based on the ipse dixit of the management as to the quantum of indebtedness without it being required to be established elsewhere. The appellants assert that the three counts of oppression found in favour of the respondents upon the amended provisions being held illegal were perverse. The fact that the amendments followed vague charges made against the appellants could not lead to the conclusion of retaliation as found by the Board. The appellants assail the finding as to the legality of the amended provisions being arrived at on the twin additional tests of discrimination and the reason for forfeiture having no nexus with the respondents' right as shareholders. The appellants are aggrieved by the conclusion that the amendments were unnecessary as alternative remedy for pursuing the company's dues against the respondents was available and had been availed of.

4. It is submitted on behalf of the appellants that the Board had accepted that some of the respondents had notice of the general meetings whereat resolutions in support of the amendments were carried and had not been objected to, but had still permitted such respondents to question the legality of the amendments. The appellants point out that some of the respondents had purchased some of the forfeited shares upon their reallocation and that other reallocatees, who were sought to be affected by the orders prayed for and obtained, had not been impleaded in the proceedings before the Board.

5. Article 7 of the company's articles of association was amended on July 9, 2004 and May 28, 2005, by incorporating Clauses (e) and (f) therein to the following effect:

(e) Any member who has been declared a defaulter by the company by reason of his failure to fulfil any financial engagement between himself and the company

and who fails to fulfil such engagement within 15 days from the date upon which he has been so declared defaulter, shall at the expiration of such period of 15 days automatically cease to be a member and shares held by such member shall ipso facto be forfeited and any share so forfeited shall be declared to be the property of the company and the company shall sell, re-allot and otherwise dispose of the same in such manner to the best advantage for the satisfaction of all dues which may then be due and owing to the company (amended vide resolution dated July 9, 2004).

(f) A member of the company will be expelled if the member deserts the company and ceases to be a business associate/partner of the company and in such a situation, to protect the sanctity and interests of its own the company will forfeit the shares of such a member and any share so forfeited shall be declared to be the property of the company, shall sell, re-allot and otherwise dispose of the same in such manner as the directors of the company would deem fit... (amended vide resolution dated May 28, 2005).

6. Over the several pages that the Board has expended after noticing the amendments, it referred to the charges of mismanagement levelled by the respondents and concluded, after setting down the five tests of oppression, that the appellants' conduct was oppressive, burdensome, harsh and wrongful and that such conduct resulted in justifiable lack of confidence. The prayers 8(c), 8(d), 8(e) and 8(h) were allowed. All the prayers relate to the amendments and the consequential forfeiture of shares. The reference to the charges of mismanagement, thus, were viewed only as a prelude to the act of retaliation by the appellants of introducing the amendments as no relief was granted for the alleged acts of mismanagement. The prayers allowed were the following:

(c) declare that petitioners Nos. 1 to 17 are the true and lawful owners and holders of an aggregate 16,800 number of equity shares fully paid-up of and in the respondent-company ;

(d) declare that the purported forfeiture of the shares held by petitioners Nos. 1 to 17 are bad, illegal and null and void ;

(e) direct the respondents to cancel, rescind and/or withdraw the purported special resolution dated July 9, 2004, purporting to amend the articles of association without the knowledge of the petitioners and inserting the Clause of forfeiture illegally and the said special resolution may be declared inoperative and illegal;

(h) direct the respondents to cancel, rescind and/or withdraw the special resolution dated May 28, 2005, of forfeiting the shares of petitioners Nos. 1 to 17 herein.

7. The impugned judgment and order deals only with the case of oppression put forward by the respondents herein. Though there is a line found in the judgment that the appellants herein had not provided any answers to specific instances of

mismanagement complained of in the petition before the Board, such instances of mismanagement are not weighed on evidence as is generally required. Though there is no independent appeal by the respondents to challenge the refusal of the other prayers contained in the petition before the Board which were based on charges of mismanagement, there is some justification that if, indeed, the respondents' case of mismanagement was believed appropriate orders ought to have followed.

8. The Board held that the idea of introducing the amendments to the articles by those in management of the company was an act of oppression, calculated to oust persons who had raised questions that inconvenienced those who controlled the company. If the Board had rested there, the appellants would have little ground to challenge the conclusions drawn on facts in an appeal restricted to questions of law. But the appellants question the Board's approach to the issue. The Board proceeded to test the legality of the amendments and held that forfeiture of shares on the grounds of cessation of business and non-payment of dues were alien to corporate jurisprudence. Having found that the amendments were not permissible in law, the Board then sought reasons as to what prompted those in management of the company to resort to such acts of illegality. If this first step, that of finding that the amendments were illegal, was not there, the appellants would have found the ultimate conclusion difficult to challenge as such conclusion is on facts and on the Board's appreciation of facts which would not ordinarily be upset unless found perverse.

9. In reaching a finding that the incorporation of the two additional Clauses were illegal, the Board was of the opinion that the nature of business carried on by member was irrelevant in the context of his membership. The Board also opined that a company's claim on account of business transactions with a member could not impact his rights qua member. With respect, the generalised findings on such counts are flawed, though it is not impossible that in a particular case either conclusion may be valid on facts.

10. A member's business may have a direct bearing on his membership. The first example that comes to mind is of stock brokers forming a company. The right to be a member of a stock exchange company is generally reserved only for stock brokers. There are companies where membership is restricted to dealers of a particular commodity or to members in the music trade. If a company can be incorporated with restrictions as to the type of persons who may be its members, provisions can also be introduced in the articles by amendment that confine members to a class of persons having a common business. The genesis of this company, notwithstanding the restrictions as to membership not being there at its inception, would show that cable operators got together to form it. If the company later resolved to confine its membership to only cable operators in business, the relevant amendment cannot on such count be held to be illegal.

11. The finding of illegality on other count can also not be sustained. If a company's only business is to provide service to its members and some of the

members failed to pay for the services, the company's articles may permit it to expel such members. Social clubs are examples that immediately come to mind. Again, if a company could have had such power of expulsion, which is what forfeiture is, it would not be illegal if a provision for forfeiture or expulsion is subsequently incorporated in the articles of a company. It is an entirely different matter altogether that such provision may be misused and which, on facts, may be found to have been misused and may form, and be held, as a ground of oppression. But the legality of the provision cannot be doubted on the basis of the manner of its application. The one relates to the authority, and the other relates to reasonableness of exercise of such authority. The unreasonable exercise of authority would not corrupt the source of the authority or render the authority questionable.

12. The final conclusions of the Board in the instant case were tinged by the finding of illegality. It appears the question that the Board proceeded to answer was as to why the management resorted to such acts of illegality. If the Board had posed the same question without referring to the alleged illegality, it is possible that it may have arrived at the same conclusion. But it has tainted the question with its conclusion of illegality and, thus, the answer cannot be sustained. In holding that there was per se illegality in the conduct of those in management of the company, a high test of justification was set for the appellants which the appellants, in the Board's opinion, could not meet. If the Board had formed a view that the amendments, or material parts thereof, were permissible, then a lesser test was required to be set for the appellants : the test that, despite the acts complained of being legal, whether the brute majority of the management's numerical strength was used to ride roughshod over the contesting respondents to maim them as to the charges of defalcation brought against the management. It was this simple test that was required to be applied and it would not suffice that such simple test can be severed from the finding of legality in the impugned judgment.

13. Of the various decisions referred to in the impugned judgment, the appellants cite two that, according to the appellants, would establish the legality of the amendments introduced. The appellants rely on the judgment of the Court of Appeal reported at *Sidebottom v. Kershaw, Leese and Co. Ltd.* [1920] 1 Ch. D 154, and the Supreme Court judgment in *Naresh Chandra Sanyal Vs. Calcutta Stock Exchange Association Ltd.*, . The appellants submit that the *Naresh Chandra Sanyal Vs. Calcutta Stock Exchange Association Ltd.*, , was a complete answer to the question of legality as to the amendments raised by the Board and despite such high authority being cited, the Board took, effectively, a view that is inconsistent with the opinion of the Supreme Court.

14. The Court of Appeal was considering a question as to the validity of a, resolution to alter the articles that provided, upon alteration, that the directors should have the power to require shareholders who carried on business in competition with the company's to transfer their shares to nominees of the

directors. The article that was impugned in that case was in the following terms (page 155):

In every case where shares are held by a person who carries on any business which is in direct competition with the business of the company, or who is a director of any company carrying on such business, the directors may at any time give to such person notice requiring him forthwith to transfer all such shares, and he shall thereupon be bound, upon payment of the fair value of the shares to be ascertained as stated in Article 38, to transfer the shares to such person or persons as the directors shall nominate.

15. Some of the members who were affected or likely to be affected brought a suit and it was held by the vice-chancellor that any valid alteration to the articles capable of being enforced upon a minority of the shareholders must be within the ordinary principles of justice, and must be for the benefit of the company as a whole. Upon applying such tests, it was held that the proposed article was invalid as it would enable the directors to compulsorily expropriate a competing shareholder. There was no dispute in that case that the plaintiffs were in competition with the company. The Court of Appeal discharged the judgment of the vice-chancellor by relying on the following principle (page 162):

Possibly the limitation on the power of altering the articles may turn out to be that the alteration must not be such as to sacrifice the interests of the minority to those of a majority without any reasonable prospect of advantage to the company as a whole.

16. In the present case, the company came to be incorporated by cable operators who pooled in their resources to have better bargaining power against such person from whom they would collectively receive the signals for distribution inter se. Per se illegality could not be attributed to the company, as the Board did, for introducing a provision that would require members who had aligned with a rival to be required to sever their ties with the company.

17. In the Naresh Chandra Sanyal Vs. Calcutta Stock Exchange Association Ltd., , the legality of a series of articles was questioned. Paragraph 4 of the report sets out the relevant articles (pages 53 to 55):

Article 21.--The committee shall have power to expel or suspend any member or if being firm any member or authorised assistant of the firm in any of the events following:....

(6) If the member or if being a firm any member or authorised assistant of the firm refuses to abide by the decision of the committee in any matter which under these articles or under the bye-laws for the time being in force is made the subject of a reference to the committee....:

Provided always that in every case arising under the provisions of Sub-sections (5), (6), (7) and (8) of this article no resolution for the expulsion of a member or if being a firm any member or authorised assistant of the firm shall be valid

unless passed by a majority consisting of not less than two-thirds of the members of the committee at a meeting specially convened for the purpose and at which meeting not less than two-thirds of the members of the committee at a meeting specially convened for the purpose and at which meeting not less than seven members of the committee shall be present.

Article 22.--Any member who has been declared a defaulter by reason of his failure to fulfil any engagement between himself and any other member or members and who fails to fulfil such engagements within six months from the date upon which he has been so declared a defaulter shall at the expiration of such period of six calendar months automatically cease to be a member.

Article 24.--Upon any member ceasing to be a member under the provisions of Article 22 hereof and upon any resolution being passed by the committee expelling any member under the provisions of Article 21 hereof or upon any member being adjudicated insolvent the share held by such member shall ipso facto be forfeited.

Article 27.--Any share so forfeited shall be deemed to be the property of the association, and the committee shall sell, re-allot and otherwise dispose of the same in such manner to the best advantage for the satisfaction of all debts which may then be due and owing either to the association or any of its members arising out of transactions or dealings in stocks and shares.

Article 28.--Any member whose share has been so forfeited shall notwithstanding be liable to pay and shall forthwith pay to the association all moneys owing by the member to the association at the time of the forfeiture together with interest thereon, from the time of forfeiture until payment at 12 per cent, per annum and the committee may enforce the payment thereof, without any deduction or allowance for the value of the share at the time of forfeiture.

Article 29.--The forfeiture of a share shall involve the extinction of all interest in and also of all claim and demands against the association in respect of the share, and all other rights incidental to the share, except only such of those rights as by these articles expressly saved.

Article 31.--The association shall have a first and paramount lien upon the share registered in the name of each member and upon the proceeds of sale thereof for his debts, liabilities and engagements....

Article 32.--For the purpose of enforcing such lien the association may sell the share subject thereto in such manner as they think fit....

Article 33.--The net proceeds of any such sale shall be applied in or towards satisfaction of the debts, liabilities, or engagements, residue (if any), paid to such member, his executors, administrators, committee curator or other representatives.

18. The Supreme Court referred to an old decision of this Court reported at

Calcutta Stock Exchange Association Ltd. v. S.N. Nandy and Co. ILR [1950] Cal 235, and relied on the tests applied by Harries, C.J., to reject charges of illegality levelled against the articles. The Supreme Court recognised the stock exchange's power under the articles to expel a defaulting member and to realise the dues of the stock exchange from out of the fair value of the forfeited shares of such member.

19. Forfeiture on such account is not alien to corporate jurisprudence as the Board found in the impugned judgment. It is a power that the articles can confer. The use of such power has to be reasonable but the authority cannot be negated merely because the exercise of the authority is found to be open to misuse. It is possible that the facts in the instant case can be such that the exercise of the authority granted by the amended articles can be found to be unfair or oppressive. But to arrive at a conclusion of oppression on the understanding that the company could not assume such authority, is fallacious. Again, it is possible that the amendments, though legal, were introduced with improper motive and rather than achieve a benefit for the company, were mooted with the idea of rooting out complaining members.

20. The Constitution mandates that the law laid down by the Supreme Court is binding. If the Board had referred to the Naresh Chandra Sanyal Vs. Calcutta Stock Exchange Association Ltd., , a bit more than making a passing mention of it, the conclusion of illegality arrived by it may have been avoided.

21. Since the Board only passed orders relating to the amendment of the articles and the consequential forfeiture on its assertive conclusion that such action was alien to corporate jurisprudence, the considerations that followed cannot be sustained. The judgment and order of the Board is set aside and the matter is remanded for being considered afresh. The other issues raised by the parties, both as to the propriety of the judgment and as to other aspects not being considered, have not been dealt with and all matters are left open, save the legality of the two articles that have been introduced if the motive thereof is not found questionable. However, even by the tests recognised by the Court of Appeal and the Supreme Court, such parts of the amended articles that deny the value of the forfeited shares to the erstwhile member, cannot be sustained. Even if forfeiture in accordance with the amended articles may be permissible, the member has to be given fair value of the forfeited shares, though the company may retain such part of the value that would satisfy the company's dues against the erstwhile member.

22. There will, however, be no order as to costs.

Urgent photostat certified copies of this judgment, if applied for, be issued to the parties upon compliance with requisite formalities.