
(1978) 06 KL CK 0004

In the High Court Of Kerala

Case No : Criminal M.P. No. 1041 of 1977

M. Velayudhan

APPELLANT

Vs

Registrar of Companies

RESPONDENT

Date of Decision : 07-06-1978

Acts Referred:

Companies Act, 1956 — Section 260, 372(14), 372(2), 372(4), 4
Criminal Procedure Code, 1973 (CrPC) — Section 482

Citation : (1978) 06 KL CK 0004

Hon'ble Judges : Subramonian Poti, J

Bench : Single Bench

Advocate : L.M. Singhvi, M. Ratna Singh, K.P. Dandapani and Sumathi Dandapani, for the Appellant; M.B. Kurup, for the Respondent

Judgement

Subramonian Poti, J.—The petitioners have, by this petition, moved this court u/s 482 of the Cr. P.C. seeking to quash a complaint dated 19th July, 1977, filed before the Chief Judicial Magistrate, Calicut, by the Registrar of Companies, the respondent in this petition. The four petitioners are the directors of a company by name, M/s. Sudarsan Trading Company Ltd. (hereinafter referred to for the sake of convenience as "Sudarsan"). The complaint has been filed by the Registrar of Companies complaining of contravention of Section 372 of the Companies Act, 1956, by the petitioners who are directors of Sudarsan and, therefore, seeking the imposition of penalties u/s 374 of the Companies Act. The petitioners seek to make out that on the facts averred in the complaint no case for prosecution is made out. It is further the case of the petitioners that there is no basis for taking action by filing complaint before the Chief Judicial Magistrate. According to them, the petitioners will be put to considerable hardship if action is taken on the complaint filed before the Chief Judicial Magistrate and in the circumstances of the case it would be appropriate for this court to quash the complaint pending before the learned Chief Judicial Magistrate, Kozhikode, in S.T. 211 of 1977.

2. M/s. Sudarsan Trading Company is a public company. The authorised capital of the company is Rs. 50 lakhs divided into 2,55,000 equity shares of Rs. 10 each and 2,45,000 shares of Rs. 10 each (equity/preference shares). The subscribed capital of M/s. West Coast Industrial Gases P. Ltd. is Rs. 15,07,000 as evidenced from the balance-sheet as at June 30, 1976. The case which is the basis for the complaint by the Registrar is that Sudarsan acquired on September 22, 1976, more than 54 per cent. of the subscribed capital of M/s. West Coast Industrial Gases P. Ltd. (referred to hereinafter as "West Coast Gases" for convenience) a company incorporated on June 28, 1972. It is the case of the complainant that in doing so Sudarsan invested in M/s. West Coast Gases more than 10 per cent. of its subscribed capital and also an amount in excess of 30 per cent. of its own subscribed capital. This was done without the prior approval of the Central Government and the resolution of the general body as required u/s 372(4) of the Companies Act. It is said that thereby the provisions of Sub-section (4) read with Sub-section (2) of Section 372 of the Act have been violated.

3. The facts are admitted. That M/s. Sudarsan has acquired more than 51 per cent. of the subscribed capital of the West Coast Gases is a fact conceded by the petitioner before this court. But it is said that prior to this, on September 19, 1976, an agreement was entered into between Sudarsan on the one hand and the West Coast Gases on the other (I may refer to the parties as first and second party to the agreement respectively) whereunder the first party agreed to finance the second party to meet its requirement in consideration of which the second party agreed to empower the first party to have control over the composition of the board of directors and to nominate the majority of the number of directors as per Article 98 of the articles of association of the second party. The second party was engaged in manufacturing oxygen and ancillary products. For completing the project of installing an acetylene plant and to provide for the working capital requirement of the project as a whole the second party required finance and the first party had been contacted for providing such finance. The agreement was entered into as a consequence. The agreement is annex. "B" to the petition. I may refer to the relevant Clauses in the agreement. Clause 1 provides for an advance being made by the first party of an amount not exceeding twenty lakhs of rupees. Clause 3 provides for the right of the first party to have absolute power to nominate the majority of the number of directors. Clause 4 provides that the nominee directors shall be entitled to all rights and privileges of a director of the second party and shall also have the right to attend all general meetings. Clause (5) provides that the second party is to co-opt the nominees of the first party to the board. These clauses, for the sake of convenience, may be extracted here.

"1. The party of the first part shall advance by way of loan or by chits an amount not exceeding Rs. 20,00,000 (Rupees Twenty lakhs only) either in lump sum or in instalments for meeting the requirements of the party of the second part for the capital outlay as well as the working capital requirements.....

3. The party of the first part shall have the absolute power in its discretion to nominate the majority of the number of directors as provided in the Article 63 of the articles of association of the party of the second part.

4. (i) The nominee directors shall be entitled to all rights and privileges of a director of the party of the second part and shall also have the right to attend all general meetings.

(ii) Such director as well as the party of the first part shall be entitled to receive all notices and other communications (including agenda) relating to meetings of the board and its committees and general meetings of the party of the second part.

5. The party of the second part shall immediately convene a meeting of the board of directors and co-opt the nominees of the party of the first part as the additional directors u/s 260 of the Act. These nominated directors retiring at the next or subsequent annual general meetings shall be either re-appointed at the annual general meeting or co-opted to the board u/s 260 in the following years as long as this agreement subsists."

4. It may also be useful to refer to Clause 6 which enables the first party to call back the loan advanced either in instalments or in lump sum and reserves its right to convert the loan fully or partly into equity or preference shares at its option. That clause reads :

"The party of the first part may either call back the loan either in instalments or in lump sum or reserve its right to convert this loan of Rs. 20,00,000 (Rupees twenty lakhs only) fully or partly into equity or preference shares at its option."

5. It is the case of the petitioners that having entered into the agreement on September 10, 1976, the board of directors were nominated on September 20, 1976. They were co-opted to the board on the same day and, therefore, with effect from September 20, 1976, the first party had the control envisaged in Clause 3 of the agreement, annex. "B". The short question that arises for consideration in this case is the effect of the clause providing for the right to nominate the majority directors and the right said to have been exercised by Sudarsan under the terms of the agreement.

6. Section 372(1) of the Companies Act prohibits the purchase of or the subscribing for the shares of any other body corporate by a company except to the extent provided in the section and except in accordance with the restrictions and conditions specified in that section. Therefore, the acquisition of shares of any other body corporate by a company was to be only in accordance with the provisions in the several Sub-sections of Section 372 of the Act. Sub-section (2) of that section runs as follows :

"The board of directors of the investing company shall be entitled to invest in any shares of any other body corporate up to ten per cent. of the subscribed capital of such other body corporate :

Provided that the aggregate of the investments so made by the board in all other bodies corporate shall not exceed thirty per cent. of the subscribed capital of the investing company :

Provided further that the aggregate of the investments made in all other bodies corporate in the same group shall not exceed twenty per cent. of the subscribed capital of the investing company. "

7. Evidently this sub-section provides for 3 restrictions, though the subsection is not framed in the form of a restriction but as an enabling provision. (1) The board of directors of an investing company is restricted in the matter of investment in shares of any other body corporate up to 10 per cent. of the subscribed capital of the other body corporate. (2) The aggregate of the investments so made by the board in all other bodies corporate shall not exceed 30 per cent. of the subscribed capital of the investing company, and (3) The aggregate of the investments so made by the board in all other bodies corporate in the same group is not to exceed 20 per cent. of the subscribed capital. There is an exception to this rule and that is provided in Sub-section (4). That reads ;

"The investing company shall not make any investment in the shares of any other body corporate in excess of the percentages specified in subsection (2) and the provisos thereto, unless the investment is sanctioned by a resolution of the investing company in general meeting and unless further it is approved by the Central Government:

Provided that the investing company may at any time invest up to any amount in shares offered to it under Clause (a) of Sub-section (1) of Section 81 (hereafter in this section referred to as rights shares) irrespective of the aforesaid percentages :

Provided further that when at any time the investing company intends to make any investments in shares other than rights shares, then, in computing at that time any of the aforesaid percentages, all existing investments, if any, made in rights shares up to that time shall be included in the aggregate of the investments of the company."

8. It is evident that any investment in excess of that permitted by Sub-section (2) would be valid if it is sanctioned by a resolution of the investing company in general meeting and approved by the Central Government. It may not be necessary to refer to the other sub-sections excepting Sub-section (14) which exempts certain categories of cases from the operation of Section 374. That sub-section provides that that sub-section will not apply to certain investments and one of them is that in Sub-clause (d) of Sub-section (14). That reads :

"(14) This section shall not apply--.....

(d) to investments by a holding company in its subsidiary : "

9. Evidently the case against Sudarsan in the complaint by the Registrar of

Companies is that by acquiring the shares of M/s. West Coast Gases in excess of 10 per cent. of its subscribed capital and by investing by such acquisition an amount in excess of the 30 per cent. of the subscribed capital of the investing company Sub-section (2) of Section 372 has been contravened. There is no case that Sub-section (4) of the section would save the situation, for, it is not the case of Sudarsan that the investment was sanctioned by the resolution of the investing company in general meeting and that it was approved by the Central Government. But the answer is that Sub-section (2) of Section 372 will not be applicable for the reason that it is one of those cases to which Section 372 itself will not apply as the investment made by Sudarsan in M/s. West Coast Gases is an investment by a holding company in its subsidiary falling within Section 372(14)(d) of the Companies Act. To appreciate this contention it maybe necessary to understand the term "holding company" and "subsidiary". The definition of those terms is in Section 4 of the Act. Sub-sections (1) and (2) of Section 4 which alone may be necessary for our purpose here, run thus :

"4. (1) For the purposes of this Act, a company shall, subject to the provisions of Sub-section (3), be deemed to be a subsidiary of another if, but only if,--

(a) that other controls the composition of its board of directors ; or

(b) that other-

(i) where the first-mentioned company is an existing company in respect of which the holders of preference shares issued before the commencement of this Act have the same voting rights in all respects as the holders of equity shares, exercises or controls more than half of the total voting power of such company ;

(ii) where the first-mentioned company is any other company, holds more than half in nominal value of its equity share capital; or

(c) the first mentioned company is a subsidiary of any company which is that other's subsidiary.

(2) For the purposes of Sub-section (1), the composition of a company's board of directors shall be deemed to be controlled by another company if, but only if, that other company by the exercise of some power exercisable by it at its discretion without consent or concurrence of any other person, can appoint or remove the holders of all or a majority of the directorships; but for the purposes of this provision that other company shall be deemed to have power to appoint to a directorship with respect to which any of the following conditions is satisfied, that is to say-

(a) that a person cannot be appointed thereto without the exercise in his favour by that other company of such a power as aforesaid ;

(b) that a person's appointment thereto follows necessarily from his appointment as director, managing agent, secretaries and treasurers, or manager of, or to any other office or employment in, that other company; or

(c) that the directorship is held by an individual nominated by that other company or a subsidiary thereof. "

10. According to the petitioners" counsel Sudarsan is a holding company and M/s. West Coast Gases is a subsidiary of Sudarsan. Two independent reasons are indicated. Firstly, it is so because Sudarsan controls the composition of the board of directors of West Coast Industrial Gases Ltd. Secondly, Sudarsan held more than half of the nominal value of the equity share capital of West Coast Industrial Gases Ltd. and, therefore, the investment was in a subsidiary company. It is necessary to note the relevant dates to appreciate the contentions. Sudarsan is said to have become a holding company by reason of the exercise of the power under Clause 3 of the agreement dated September 19, 1976 on September 20, 1976. It is, therefore, said that if not from the 19th, the date of agreement, at least from 20th Sept, the date on which the power to nominate the majority number of board of directors was exercised Sudarsan became a holding company in West Coast Gases, a subsidiary company. Therefore, when on September 22, 1976, more than 51 per cent. of the shares of the West Coast Gases was acquired by Sudarsan it was investing in a subsidiary company and as an investment by a holding company in a subsidiary company it was outside the purview of Section 374 by reason of Section 372(14)(d) of the Act. Though there is also a plea that, even otherwise, the investment on September 22, 1976, in West Coast Gases must itself be taken as investment in subsidiary company even if on that day that had not become a subsidiary company by reason of the power to control the composition of the board of directors that case could be easily answered with reference to Section 372(14)(d) of the Act. That takes in only the case of investment by a holding company in a subsidiary. If at the time the investment was made the investing company was not a holding company but could become the holding company only by reason of such investment, for the same reason the investment could not be said to be made in a subsidiary company. The investment may be by a company to make the other company a subsidiary. Hence, petitioners may not succeed in that contention. But the larger contention is, as indicated, that on the date of investment, namely, September 22, 1976, Sudarsan and West Coast Gases had already been related as holding company and subsidiary and, therefore, the investment of more than the percentage of subscribed capital contemplated by Sub-section (2) of Section 372 was unobjectionable and not hit by Section 372. Hence, the question which I will now examine is whether on September 22, 1976, the West Coast Gases had become a subsidiary company by reason of the power of control in Sudarsan and that is whether by reason of the agreement which is annex. "B", Sudarsan controlled the composition of the board of directors of West Coast Gases. The term "controls the composition of board of directors" is to be read in accordance with and only in accordance with Sub-section (2) of Section 4 of the Act and that Sub-section conceives of control if, but only if, the company which claims control can appoint or remove the holders of all or a majority of the directorships by the exercise of some power exercisable by it at its discretion without the consent or

concurrence of any other person. Section 4 of the Companies Act envisages the existence of subsidiary companies in different circumstances. It may be that by acquiring sufficient share capital of a company sufficient control may be obtained over that company to enable control in the composition of board of directors. But it is also possible to obtain such control in regard to the composition of the board without making such an investment in equity capital of the company. Such a control may be by reason of an agreement such as where one company may agree to advance funds to another company and in return may, under the terms of an agreement surrender control over the right to appoint all or a majority of the board of directors. The first of the cases envisaged in Sub- Section (4) is the case where a control is obtained by a company in the matter of composition of the board of directors of another company. That would be sufficient to constitute the former as holding company and the other as subsidiary. The second type of cases is where more than half the nominal value of the equity share capital is held by another company. By virtue of such holding that other company becomes a holding company and the one whose shares are so held becomes a subsidiary company. The 3rd case envisaged is where a subsidiary company of a holding company may be a holding company in relation to another company. That other company is also a subsidiary of the holding company of the subsidiary. Section 4 envisages yet another case and that relates to existing company in respect of which the holders of preference shares issued before the commencement of the Act exercise or control more than half of the total voting power of such company.

11. I have already noticed that the power to control the composition of board of directors need not be by reason of control exercised by reason of share in the equity capital of the subsidiary company. If it is to be by the terms of a contract, by its very nature the circumstances would be reversible. It may be open to the parties to agree that either on the happening of any event or on the expiry of the term agreed upon or at will, the contract which gives the right to control the composition of the board of directors may stand terminated. Therefore, that it is limited in point of time does not derogate from the nature of the power to control the compositions of the board of directors. There may be instances where a company may be interested in controlling the composition of the board of directors of another only so long as it is interested in that by reason of its commitments, such as financing. When once the financing arrangements come to an end by volition of either party there may be no more reason to continue such control and hence the terms of the contract may provide for exercise of control only for a limited period and not in perpetuity. I have already adverted to the relevant terms of annex. "B" agreement. Clause 3 of the agreement, as I have indicated, gives absolute power to Sudarsan to nominate the majority of the number of directors of M/s. West Coast Gases. Such directors are entitled to all the rights and privileges of the other directors. Clause 5 specifies the machinery or a procedure by which the nomination by Sudarsan has to be made effective. It is in this context that reference has to be made to Section 260 of the Companies Act. While Sections 255 and 256 deal with the appointment of directors, Section

260 provides that notwithstanding the provisions in Section 255, 258 or 259 the power conferred on the board of directors by the articles to appoint additional directors shall not be affected provided that such additional directors shall hold office only up to the next annual general meeting of the company. Reference has been made in the agreement, in the clause relating to power of appointment of the board of directors, to the appointment of additional directors. Though Section 260 gives such power it is the case for the counsel for the respondent that such power cannot be taken to be a power falling within Section 4(1)(a) of the Companies Act to control the composition of the board of directors. The total number of directors permitted for the West Coast Gases is 9 and out of this 3 alone had been appointed. The agreement provides for appointing the majority of directors at any time and since at the moment there were only 3 directors, Sudarsan appointed 4 directors. Going by the terms of the agreement there is a power to appoint the majority of directors and such appointment is possible by reason of Section 260 of the Companies Act. But such appointment would enure only up to the next general meeting. Could it be said that for that reason it does not constitute a control over the composition of the board of directors ?

12. According to learned counsel for the petitioners, Dr. Singhvi, the control envisaged u/s 4(1)(a) is not any control for all time. As I said earlier it may be limited in point of time and if for any period of time such control could be exercised and that is provided for, then during that period there would be the relation of holding company and subsidiary company. In the view that I have taken that in a case where the control in regard to the composition of board of directors arises by reason of the terms of agreement, such control may be for a limited period, which is contemplated by the terms of the agreement, and I see no reason to hold that since a majority of directors appointed pursuant to the power under the agreement could hold office only till the next general meeting it cannot operate as a control in the matter of the appointment of board of directors. In other words, in a case where appointment is governed by provisions of Section 260 of the Act and is, therefore, limited in point of time to the date of the next annual general meeting of the company there would still be control in the matter of composition of the board of directors for the period up to the next annual general meeting and, therefore, it is possible for the relationship of a holding company and subsidiary company to subsist during that time.

13. There is a further question whether the terms of the agreement here could be read as one conferring on Sudarsan the power to appoint the board of directors of West Coast Gases. It is true that it is not Sudarsan which appoints the board of directors. It only nominates and the appointment has to be made by co-option as contemplated u/s 260 of the Companies Act by the existing members of the board. That of course is the machinery by which the right to nominate is to be operative. There is a compelling obligation on the part of West Coast Gases to co-opt on such nomination being made. Reference to Section 4(2) (c) of the Companies Act may be useful in this context. That provides that the power to appoint a director is assumed when the directorship is held by an

individual nominated by the company which claims control. Therefore, if there is a power to nominate and it is the person who is so nominated that is to hold the post of director that amounts to power to appoint within the meaning of Section 4 of the Act.

14. Counsel Sri M.B. Kurup appearing for the respondent in this case relied on the words "without the consent or concurrence of any other person" in Sub-section (2) of Section 4 of the Act to claim that this was not a case where Sudarsan can appoint any director to West Coast Gases Ltd. without the consent or concurrence of any other person. Though learned counsel explains the term "without the consent or concurrence of any other person" as meaning not the subsidiary company but any person other than the subsidiary company, I am not considering that construction here, for, even without recourse to such construction it may be possible to answer the contention of respondent's counsel. The terms of the contract entered into between Sudarsan and West Coast Gases imposes an obligation on the part of the latter to co-opt the directors nominated by Sudarsan. There is no choice left. There is no scope for any volition on the part of the West Coast Gases. It is a legal obligation which, as a party to the contract, West Coast Gases is expected to discharge. Therefore, when once nomination is made by Sudarsan the co-option, within the meaning of Section 260, must follow as a legal obligation. When one is obliged to perform an act in terms of an agreement there is no question of such performance being based on consent. Consent and concurrence presupposes a right or freedom to disagree and when such a volition is not available to a party it cannot be said that there is any scope for consent or concurrence. Therefore, on the terms of the contract no question of withholding consent or concurrence by West Coast Gases arises.

15. On the terms of the agreement it is clear that the right to nominate the majority of the board of directors has been conferred on Sudarsan which right has been exercised on September 20, 1976. It is possible to say that the date of exercise may not be the relevant date, but the date of conferment of the power under the agreement is such relevant date. But that distinction may not be relevant in this case ; because it is subsequent to both the dates, September 19, 1976 and September 20, 1976, that the share capital was invested in West Coast Gases. Therefore, on the date such share capital was invested such investment was in a subsidiary company. If so that was unexceptionable. Sub-section (14) (d) saves the case from Sub-section (2) of that section.

16. It was argued by Shri M.B. Kurup that this is not a matter on which this court should exercise power u/s 482 of the Code. In logical sequence my consideration of this question should have come at the beginning of this judgment. But I did not deal with this question earlier because this contention too can be appreciated only on a true understanding of the facts of the case and hence it was necessary to consider the question as I have considered it here.

17. It is true that it is not in any and every case where a party comes to this

court complaining that a criminal complaint filed against him is frivolous and is without merit that the court should invoke its inherent power. There must be circumstances which warrant the exercise of the power. Where an abuse of the process of any court is made out or where the ends of justice would be served by this court making the exercise, the power u/s 482 may be made available. The maintainability of the prosecution against the petitioners would depend on the applicability of Section 372(2) of the Companies Act, a question of law which is by no means easy to decide. The parties are not at issue on any relevant question of fact. The question whether Sudarsan is a holding company is of larger relevance, in that the obligation as a holding company may have to be discharged by Sudarsan if the West Coast Gases is its subsidiary. Such obligations include the social accountability for the subsidiary company contemplated by the provisions of the Companies Act. A state of indecision by the pendency of a prosecution at the instance of the Registrar of Companies may keep the matter of performance of such obligations of the holding company in suspense, a situation which should be avoided if possible. Hence, it becomes expedient, in the circumstances of this case to have a decision by this court in proceedings u/s 482 of the Code of Criminal Procedure. The Supreme Court has spoken on the scope of High Court's power u/s 482 on several occasions and I may refer in this context to the decision in *State of Karnataka Vs. L. Muniswamy and Others*, . In para. 7 of that decision the Supreme Court said thus (p. 1492) :

"In the exercise of this wholesome power, the High Court is entitled to quash a proceeding if it comes to the conclusion that allowing the proceeding to continue would be an abuse of the process of the court or that the ends of justice require that the proceeding ought to be quashed. The saving of the High Court's inherent powers, both in civil and criminal matters, is designed to achieve a salutary public purpose which is that a court proceeding ought not to be permitted to degenerate into a weapon of harassment or persecution. In a criminal case, the veiled object behind a lame prosecution, the very nature of the material on which the structure of the prosecution rests and the like would justify the High Court in quashing the proceeding in the interest of justice. The ends of justice are higher than the ends of mere law though justice has got to be administered according to laws made by the legislature. The compelling necessity for making these observations is that without a proper realisation of the object and purpose of the provision which seeks to save the inherent powers of the High Court to do justice between the state and its subjects, it would be impossible to appreciate the width and contours of that salient jurisdiction."

18. In *Madhu Limaye Vs. The State of Maharashtra*, , the Supreme Court said thus (para. 8, page 50):

"At the outset the following principles may be noticed in relation to the exercise of the inherent power of the High Court which have been followed ordinarily and generally, almost invariably, barring a few exceptions :--

(1) That the power is not to be resorted to if there is a specific provision in the

Code for the redress of the grievance of the aggrieved party ;

(2) That it should be exercised very sparingly to prevent abuse of process of any court or otherwise to secure the ends of justice ;

(3) That it should not be exercised as against the express bar of law engrafted in any other provision of the Code."

19. Having heard both sides I feel that on the facts and in the circumstances stated here, the ends of justice will be served by exercising the power of this court u/s 482 of the Code of Criminal Procedure. In these circumstances, I quash the complaint filed by the respondent before the Chief Judicial Magistrate Court, Calicut, and proceedings pursuant thereto pending as S.T. 211 of 1977.