

**(2011) 02 DEL CK 0042**

**In the Delhi High Court**

**Case No :** R-3 W.P. (C) 14341 of 2005 and CM APPL 10758 of 2005

M.S. Kabli

APPELLANT

Vs

Union of India (UOI) and Others

RESPONDENT

**Date of Decision :** 22-02-2011

**Acts Referred:**

Companies Act, 1956 — Section 224(2), 224(3), 224(5), 224(7), 225

**Citation :** (2011) 3 AD 145 : (2011) 166 CompCas 1 : (2011) 122 DRJ 434 : (2011) 2 ILR Delhi 788

**Hon'ble Judges :** Dr. S. Muralidhar, J

**Bench :** Single Bench

**Advocate :** Ashish Makhija, Vivek Mohanty and Poulani Putaatunda, for the Appellant; S.K. Dubey and Tungesh for R-1 and 2 and Arun Kathpalia and Kamal Sawhney for R-3, for the Respondent

## **Judgement**

S. Muralidhar, J.—The Petitioner, a practicing Chartered Accountant, is the sole proprietor of M/s. M.S. Kabli & Company. The Petitioner is aggrieved by an order dated 28th July 2005 passed by the Regional Director (Northern Region), Ministry of Company Affairs, Government of India according approval u/s 224(7) of the Companies Act, 1956 ("Act") for removal of the Petitioner as statutory auditor of M/s. Super Cassette Industries Limited ("SCIL").

2. The Petitioner was first appointed as the statutory auditor of SCIL in the year 1992. Thereafter, the Petitioner was reappointed as a joint statutory auditor of SCIL in the Annual General Meeting ("AGM") of SCIL held on 30th September 2003 and further reappointed as such at the AGM held on 30th September 2004. On 9th May 2005 an application was filed by SCIL before Respondent No. 1 u/s 224(7) of the Act seeking approval for the removal of the Petitioner. On 10th May 2005 an Extraordinary General Meeting ("EGM") of the SCIL was held and a special resolution passed for removal of the Petitioner as the joint statutory auditor subject to approval by the Central Government.

3. The Regional Director considered the reply sent by the Petitioner to the

application filed by the SCIL. There were six specific grounds urged by SCIL in its application u/s 224(7) of the Act. The first was that the Petitioner did not have adequate infrastructure to conduct the audit. This was negated by the Regional Director as being without merit since the Petitioner had conducted the audit of the SCIL as the sole auditor continuously for 13 years up to the year ending 31st March 2003. Moreover, the appointment had been made at the AGM held on 30th September 2004 on the recommendation of the Board of Directors of the company, knowing fully well about the Petitioner's infrastructure.

4. The second ground was that the Petitioner did not possess sufficient expertise in taxation matters. This was also negated by the Regional Director holding that the SCIL is always free to appoint/engage a person of its choice for taxation matters.

5. The third ground was that there was inordinate delay in completion of the audit. This was negated by the Regional Director since the SCIL had failed to produce evidence to substantiate this allegation.

6. The fourth ground was that on account of delay caused by the Petitioner, SCIL could not submit its balance sheet to the Copyright Board before 31st March 2004. The impugned order noted that the balance sheet was signed by the statutory auditors on 3rd September 2004 and therefore, SCIL could have summoned the AGM at a short notice to adopt the balance sheet and file it before the Copyright Board well before 15th September 2004.

7. The fifth ground that the Petitioner had misbehaved with the staff of SCIL was also disbelieved. The sixth ground that the Petitioner was not present at the time of physical verification of stocks on 31st March 2005, was also negated. It was held that the statutory auditors were not always expected to be present at the time of physical verification of stocks.

8. After having rejected all the above grounds, the impugned order accepted the submission of SCIL that it had lost confidence in the Petitioner. Relying on the judgment of this Court in *Basant Ram and Sons v. Union of India* (UOI) 87 (2000) DLT 838, the Regional Director proceeded to accord approval u/s 224(7) of the Act for removal of the Petitioner.

9. Mr. Ashish Makhija, learned Counsel for the Petitioner at the outset submitted that the Petitioner was only interested in ensuring that the impugned order is set aside but not interested in other consequential relief's. It was specifically stated that the Petitioner was not interested in continuing as the statutory auditor of SCIL. Mr. Makhija further submitted that when all the grounds on which the SCIL applied to the Central Government for approval of the removal of the Petitioner have been negated by the Regional Director, such approval could not have been granted only on the ground of loss of confidence. Clearly, there was no basis for accepting such a plea when all other pleas were found to be untrue.

10. Appearing for SCIL Mr. Arun Kumar Kathpalia, learned Counsel submitted

that the decision in *Basant Ram & Sons* explained that the grounds on which auditors can be removed included loss of confidence. He also wondered whether setting aside the impugned order at this stage would cause complications vis-à-vis the actions taken consequent to the impugned order. Mr. Kathpalia added that a reading of Section 224(7) read with Section 225 of the Act would show that these provisions were meant to protect the interests of the company and not so much the statutory auditors.

11. The above submissions have been considered. The impugned order of the Regional Director negated all the contentions of the SCIL regarding the conduct and competence of the Petitioner. However, the impugned order accepted the plea of the SCIL that it had lost confidence in the Petitioner and proceeded to grant approval for removal of the Petitioner on that basis. On the face of it, the impugned order is untenable in so far as it negated all the grounds concerning the conduct and competence of the Petitioner as alleged by the SCIL before the Regional Director and yet accepted its plea that it has lost confidence. 12. Section 224(7) and Section 225 of the Act which are relevant for this purpose read as under:

Section 224(7) Except as provided in the proviso to Sub-section (5), any auditor appointed under this Section may be removed from office before the expiry of his term only by the company in general meeting, after obtaining the previous approval of the Central Government in that behalf.

Section 225 - Provisions as to resolutions for appointing or removing auditors -

(1) Special notice shall be required for a resolution at an annual general meeting appointing as auditor a person other than a retiring auditor, or providing expressly that a retiring auditor shall not be re-appointed.

(2) On receipt of notice of such a resolution, the company shall forthwith send a copy thereof to the retiring auditor.

(3) Where notice is given of such a resolution and the retiring auditor makes with respect thereto representations in writing to the company (not exceeding a reasonable length) and requests their notification to members of the company, the company shall, unless the representations are received by it too late for it to do so, -

(a) in any notice of the resolution given to members of the company, state the fact of the representations having been made; and

(b) send a copy of the representations to every member of the company to whom notice of the meeting is sent, whether before or after the receipt of the representations by the company,

and if a copy of the representations is not sent as aforesaid because they were received too late or because of the company's default the auditor may (without prejudice to his right to be heard orally) require that the representations shall be

read out at the meeting:

Provided that copies of the representations need not be sent out and the representations need not be read out at the meeting if, on the application either of the company or of any other person who claims to be aggrieved, the Central Government is satisfied that the rights conferred by this Sub-section are being abused to secure needless publicity for defamatory matter; and the Central Government may order the company's costs on such an application to be paid it in whole or in art by the auditor, notwithstanding that he is not a party to the application.

(4) Sub-sections (2) and (3) shall apply to a resolution to remove the first auditors or any of them under Sub-section (5) of Section 224 or to the removal of any auditor or auditors under Sub-section (7) of that section, as they apply in relation to a resolution that a retiring auditor shall not be re-appointed.

13. While it is true that Section 224(7) of the Act does not indicate the specific grounds on which the removal of the statutory auditor of a company can be sought, it obviously has to be for valid reasons. A plain reading of Sections 224(7) and 225 of the Act reveals that the legislative intent was to place a check on the power of the company to remove its statutory auditors. A two stage approval of the decision taken by the Board of Directors of the Company to remove the statutory auditor is envisaged. First a resolution has to be passed by the shareholders of the company at an AGM or EGM, as the case may be. Once such resolution is passed by the shareholders, the company has to seek approval of the Central Government to such removal u/s 224(7) of the Act. Section 225 of the Act ensures that there is no violation of principles of natural justice vis-r-vis the auditor. The auditor is given an opportunity of being heard by the central government. While it is true that the overall interests of the company and the creditors are to be kept in mind while deciding to either appoint or remove an auditor, the above provisions underscore that statutory auditors cannot be lightly removed. Further, the statutory procedure has to be followed. This factors in the right of the auditor to be dealt with in a fair and objective manner. The provisions recognise that auditors are expected to function as independent professionals and not simply toe the line of the management of a company. Consequently, the reasons for which a statutory auditor is sought to be removed by a company would also be relevant. The central government will have to be satisfied that the reasons are genuine keeping in view the best interests of the company and consistent with the need to ensure professional autonomy to its auditors.

14. In the considered view of this Court, the impugned order of the Regional Director undermines the above object and spirit of Section 224(7) of the Act read with Section 225 thereof. Each of the six grounds advanced by SCIL to question the competence and conduct of the Petitioner was held to be untenable. Having declined to accept those grounds, it is inconceivable that the Regional Director simply accepted the ground that the SCIL had lost confidence in the Petitioner.

15. The factual position in the present case distinguishes it from the facts in Basant Ram & Sons. Consequently, this Court does not find that the said decision assists SCIL in supporting the impugned order.

16. For all the aforementioned reasons, this Court finds the impugned order to be untenable in law and accordingly sets it aside. However, in view of the statement made by learned Counsel for the Petitioner and the apprehension expressed by learned Counsel for SCIL, this Court clarifies that the setting aside of the impugned order of the Regional Director will not result in undoing any of the actions taken pursuant to the impugned order. This Court also takes on record the statement made on behalf of the Petitioner that he does not wish to continue as a statutory auditor of the SCIL as a result of the impugned order being set aside.

17. The writ petition and the pending application are disposed of in the above terms.