

(2006) 11 KL CK 0031

In the High Court Of Kerala

Case No : Company Appeal No's. 14, 15, 17 and 18 of 2006

Westfort Hi-Tech Hospital Ltd. and Another

APPELLANT

Vs

V.S. Krishnan and Others

RESPONDENT

Date of Decision : 14-11-2006

Acts Referred:

Citizenship Act, 1955 — Section 18
Companies (Court) Rules, 1959 — Rule 3
Companies Act, 1913 — Section 81
Companies Act, 1956 — Section 143, 166(1), 172, 172(2), 172(3)
General Clauses Act, 1897 — Section 27
Negotiable Instruments Act, 1881 (NI) — Section 138

Citation : (2007) 2 CompLJ 143 : (2007) 76 SCL 185

Hon'ble Judges : M.N. Krishnan, J;J.B. Koshy, J

Bench : Division Bench

Advocate : K.P. Dandapani, for the Appellant; C.G. Sunil, Caveator, for the Respondent

Judgement

J.B. Koshy, J.—These appeals are filed questioning the correctness of the order of the Company Law Board dated 5.6.2006 under Sections 397, 398, read with Sections 402 and 403 and Schedule XI of the Companies Act, 1956 (hereinafter referred to as "the Act") [since reported as V.S. Krishnan and Ors. v. Westfort Hi-tech Hospital Ltd. and Ors. (2006) 8 C LJ 118 (CLB)]. Both sides relied on various decisions in support of their arguments. Whether and how the ratio of those decisions will be applicable in this case, can be considered only after considering the facts of this case. The apex court in Uttaranchal Road Transport Corpn. and Others Vs. Mansaram Nainwal, observed as follows at paragraph 13:

A decision is a precedent on its own facts. Each case presents its own features. It is not everything said by a Judge while giving judgment that constitutes a precedent. The only thing a Judge's decision binding a party is the principle upon which the case is decided and for this reason it is important to analyse a decision and isolate from it the ratio decidendi. According to the well-settled theory of

precedents, every decision contains three basic postulates: (i) findings of material facts, direct and inferential. An inferential finding of fact is the inference which the Judge draws from the direct, or perceptible facts; (ii) statements of the principles of law applicable to the legal problems disclosed by the facts; and (iii) judgment based on the combined effect of the above. A decision is an authority for what it actually decides. What is of the essence in a decision is its ratio and not every observation found therein nor what logically flows from the various observations made in the judgment. The enunciation of the reason or principle on which a question before a court has been decided is alone binding as a precedent : see : The State of Orissa Vs. Sudhansu Sekhar Misra and Others, and Union of India (UOI) and Others Vs. Dhanwanti Devi and Others, . A case is a precedent and binding for what it explicitly decides and no more.

The words used by Judges in their judgments are not to be read as if they are words in an Act of Parliament. In *Quinn v. Leathern* (1901 AC 495, Earl of Halsbury, L.C. observed that every judgment must be read as applicable to the particular facts proved or assumed to be proved, since the generality of the expressions which are found there are not intended to be exposition of the whole law but governed and qualified by the particular facts of the case in which such expressions are found and a case is only an authority for what it actually decides.

1.1 Therefore, facts of the case are considered first.

2. The second respondent in the company application, Dr. K.M. Mohandas, (hereinafter referred to as the "chairman") his wife (third respondent) and their children established and were carrying on the business of a hospital under partnership called "Westfort Hospitals". It was incorporated as a company in the name of "Westfort Hospitals Private Limited" on 6.4.1994. Subsequently, it changed its name as Westfort Hi-Tech Hospital Private Limited on 1.5.1997. Thereafter, it was converted as a public limited company and the word "private" was deleted and a new certificate of incorporation was issued on 18.6.1997. The issued, subscribed and paid-up capital of the company was Rs. 9,18,41,000 divided into 91,84,100 equity shares of Rs. 10 each fully paid-up as per the balance sheet as on 31.3.2005. It is the case of the petitioners that they joined the company when the company was in need of finance and chairman of the company lured doctors and other non-resident Indians to invest money when the company was being converted as public limited company on the promise that the doctors who contribute more than rupees ten lakhs and other persons who contribute more than rupees twenty lakhs would be given the office of director - so that they can ensure proper management of the company. Petitioner No. 1 has contributed rupees fifteen lakhs and petitioner Nos. 2 to 4 and respondent Nos. 5 and 14 also accordingly contributed rupees twenty lakhs and they were made directors from the inception as a public limited company and they were continuing as directors. As per the articles of association, total number of directors is 20. Two promotee directors (chairman and his wife) were permanent and 18 directors were to be elected. There were two vacancies in the board due

to resignation of two directors. One M.N. Purushothaman, who is not a relative of second respondent chairman, applied to issue duplicate share certificates stating that his shares were missing and also requested to transfer the shares. The above request was approved by the board of directors in its meeting held on 24.8.2005. It was decided to issue duplicate share certificates, as provided u/s 84 of the Act, and also to transfer the shares. Accordingly, shares were transferred. The above board meeting was also attended by the first petitioner. As decided by the board meeting on 24.8.2005, annual general body meeting was fixed to be held on 29.9.2005. Draft notice of the meeting was also approved in the board meeting. Notices were issued under certificate of posting as provided u/s 53(1)(2) of the Act. Since one-third of the directors have to retire in every annual general meeting, six directors have to retire and those vacancies are to be filled (see Sections 255 and 256). One of the agenda in the annual general body meeting was the same. Hence, following agenda was included in the notice as ordinary business: 7. To consider, and if thought fit, to appoint directors in the place of those retiring by rotation."

2.1 In the Explanatory Statement as last item, it is stated as follows:

Directors

Sri A.P. Sadanandan, Sri T.M. Balan, Sri CM. Sathiadevan, Sri V.S. Krishnan, Sri K.R. Sreenivasan and Sri K.J. Jayasurya are the directors who retire by rotation and are eligible for re-appointment.

2.2 After sending the notice for annual general body meeting, those retiring directors opted for re-appointment. The company also received notice from eight other eligible shareholders to stand for election as provided u/s 257(1). Since their names were not included in the notice for annual general body meeting as their nominations were received subsequently, it was advertised in Indian Express and Deepika which are having circulation in the place where the registered office of the company is situated, as provided u/s 256(1A) of the Act. In the above meeting, petitioners 1 to 4 and respondents 5 and 14 were not re-elected. Instead, eight other directors were elected in their place in the six vacancies caused by retirement by rotation and two vacancies caused by resignation. In the annual general body meeting it was decided to increase the share capital of the company from Rs. 9,20,00,000 to Rs. 12,00,00,000. A special resolution as provided u/s 81(1A) was moved in the annual general body meeting for issuing shares to public, but, that was not passed. It is mentioned in the report of the annual general body meeting as follows:

The chairman briefed the meeting as to raising of funds by offering shares of the company to outsiders other than existing members of the company. Members raised their voices against this proposal and they were of the opinion that the shares should be first offered to them at par and then only to outsiders and only at a premium. They were also of the opinion that at least three months' time should be given for them to subscribe the shares offered to them. After having

agreed to proposal of the members, the chairman put the business for voting on a show of hands and it was passed by a majority of votes as follows:

RESOLVED that consent of the company be and is hereby accorded u/s 81(1A) of the Companies Act, 1956 to offer or issue any number of shares in the authorized capital of the company to any person(s) whether or not those person(s) include the members of the company or not, in such manner and subject to such terms and conditions as the Board may, in the absolute interest of the company-deem fit.

2.3 To pass a special resolution, two-thirds majority was required. It is only stated that majority shareholders passed the resolution. That is not enough. Here, only conclusion possible in the special resolution to offer share to persons other than shareholders were not passed in view of Section 81(1A). Thereafter, board decided to issue right shares to all existing shareholders in the ratio of 1:4 without any discrimination.

3. Contending oppression and mismanagement, petitioners approached the Company Law Board alleging that they have invested huge sum of money on the promise that they will be continued as directors, but that promise was not honoured. It was further contended that notice to the annual general body meeting was not properly given. Special resolution was not passed regarding issue of shares. Issue of right shares was incorrect and removal of petitioners 1 to 4 and respondents 5 and 14 from the directorship and other acts done by the majority shareholders will amount to "oppression and mismanagement". It is also submitted that a special investigation centre run by chairman which was functioning in the Westfort Hi-tech Hospital on real and profit, did not make due payment and, since that was questioned, the chairman was awaiting an opportunity to remove them from the directorship. In the petition, following reliefs were sought for:

- (a) to appoint an administrator to regulate the affairs of the company in future;
- (b) to direct the administrator to lease/license the area earmarked for investigation centre to such third party as may be selected to enter into a contract with the company by making a public auction on such terms and conditions as may be approved by the administrator;
- (c) to direct the administrator to institute proceeding in the name of the company against the respondents 2 to 4, 22 and 23 who are partners of Westfort Hospital, for recovery of the amounts due ever since the date of the agreement till the date of regularization and a sum of Rs. 50,000 per month and such profits as are accrued to the firm by use of the area occupied by the partnership firm in pursuance to the agreement dated 29.12.2001 and to claim damages for use and occupation;
- (d) to declare that respondents 2 to 4 vacated office as directors of the company u/s 283 of the Companies Act, and to pass a consequential order of injunction

restraining them from acting as directors;

(e) to declare that the annual general meeting (AGM) purported to be held on 29.9.2005 is invalid and, consequently, all the resolutions purported to have been passed thereat including the election of directors are illegal and invalid;

(f) to declare that the petitioners 1 to 4 and the 14th respondent shall be deemed to have been re-elected as directors of the company and restrain first respondent company and its directors and persons claiming under them from interfering with the petitioners 1 to 4 and 14th respondent from acting as directors of the company;

(g) to declare that any purported decision to issue shares on rights basis or otherwise after 29.9.2005 as illegal and void;

(h) to pass such further and other orders to regulate the affairs of the first respondent company in future.

4. Single Member (Vice-Chairman) Bench of the Company Law Board, Chennai, held [in V.S. Krishnnn and Ors. v. Westfort Hi-tech Hospital Ltd. and Ors. (2006) 8 C LJ 118 (CLB)] that there is oppression and mismanagement mainly because the annual general body meeting held on 29.9.2005 was without proper notice. But, all decisions of the annual general body meeting were not set aside. Main reliefs granted by the impugned order are the following:

7. In view of my foregoing conclusions and (a) in exercise of the powers u/s 402; (b) to regulate the conduct of the hospital's affairs in future; and (c) in public interest, the following order is passed:

(I) It is hereby declared that-

(a) the further issue of shares impugned in the company petition is illegal and void;

(b) the election of the respondent Nos. 16 to 23 as directors is set aside;

(c) the retiring directors namely, the petitioner Nos. 1 to 4 and the respondent Nos. 5 and 14 shall be deemed to have been automatically re-appointed as directors at the eleventh annual general meeting and shall continue till the date of the twelfth annual general meeting for the year 2006; and

(d) the transfer of shares by Purushothaman in favour of the respondent Nos. 16 to 21 and others is invalid. However, Purushothaman is free to transfer his shares in accordance with the law.

(II) The company will convene and hold the twelfth annual general meeting in accordance with law to transact, inter alia, the following business:

(a) consideration of accounts, balance sheet and the reports of the board of directors and auditors for the year 2005-2006;

(b) appointment of directors in the place of those retiring and in the ex-isting vacancies;

(c) appointment of, and the liming of the remuneration of the auditors; and

(d) further issue of shares.

(III) The petitioners as well as the respondent Nos. 2 to 15 are at liberty, with a view to meet financial requirements, if any, for running the hospital, to contribute any amount by way of unsecured loans carrying interest at the prevailing bank rate to be repaid from and out of the future share application money which may be subscribed by the members, on approving the resolution for further issue of shares at the twelfth annual general meeting.

4.1 Following decisions taken were not interfered with:

In view of the gross irregularities pointed out by me in convening, holding and conducting the annual general meeting, all items of business transacted at the impugned meeting ought to be set aside. However, considering the facts that (a) the petitioners have not challenged the adoption of accounts; the appointment of auditors; the increase in borrowing powers of the directors; (b) the adoption of accounts and the appointment of auditors are statutory businesses; and (c) the increase of authorised share capital and other items of business stated herein are in no way prejudicial to the interests of the company or its shareholders, I do not propose to set aside any of these resolutions approved at the eleventh annual general meeting, save the resolutions pertaining to (a) the further issue of shares; and (b) the election of directors of the company.

4.2 In none of the appeals, the decisions of the general body as approved by the Company Law Board were challenged and that part has become final.

5. Before dealing with grounds urged in the appeal and correctness of the order of the Board, we will consider the scope of Section 397. Section 397 of the Companies Act reads as follows:

397. Application to tribunal for relief in cases of oppression-(1) Any members of a company who complain that the affairs of the company are being conducted in a manner prejudicial to public interest or in a manner oppressive to any member or members including any one or more of themselves may apply to the tribunal for an order under this section, provided such members have a right so to apply in virtue of Section 399.

(2) If, on any application under Sub-section (1), the tribunal is of opinion-

(a) that the company's affairs ate being conducted in a manner prejudicial to public interest or in a manner oppressive to any member or members; and

(b) that to wind-up the company would unfairly prejudice such member or members, but that otherwise, the facts would justify the making of a winding up order on the ground that it was just and equitable that the company should be

wound-up; the Tribunal may, with a view to bringing to an end the matters complained of, make such order as it thinks fit.

5.1 To attract Section 397, the persons complaining should prove that the affairs of the company are being conducted in a manner prejudicial to public interest or in a manner oppressive to shareholders. The court can grant the remedy only if proved facts would justify passing of winding up order on the ground that it is just and equitable, but, instead of winding up, remedies can be granted as winding up unfairly prejudice the members. While interpreting similar provision in Section 210 of the English Companies Act, 1948 and House of Lords in *Scottish Co-operative Wholesale Society Ltd. v. Meyer* (1959) AC 324, taking the dictionary meaning of the word "oppression", Viscount Simonds held that "be described as having behaved towards the minority shareholders in an "oppressive" manner, that is to say, in a manner "burdensome, harsh and wrongful".

5.2 After considering the above decision and *Meyer* (1959) AC 324 and *In re Associated Tool Industries Ltd.* (1964) A LR 73, *Jermyn Street Turkish Baths Ltd.* (1971) 3 All ER 184 etc.-the apex court in *Shanti Prasad Jain Vs. Kalinga Tubes Ltd.*, held as follows (at page 204 of Comp LJ):

These observations from the four cases referred to above apply to Section 397 also which is almost in the same words as Section 210 of the English Act, and the question in each case is whether the conduct of the affairs of a company by the majority shareholders was oppressive to the minority shareholders and that depends upon the facts proved in a particular case. As has already been indicated, it is not enough to show that there is just and equitable cause for winding up the company, though that must be shown as preliminary to the application of Section 397. It must further be shown that the conduct of the majority shareholders was oppressive to the minority as members, and this requires that events have to be considered not in isolation but as a part of a consecutive story. There must be continuous acts on the part of the majority shareholders, continuing up to the date of petition, showing that the affairs of the company were being conducted in a manner oppressive to some part of the members. The conduct must be burdensome, harsh and wrongful and mere lack of confidence between the majority shareholders and the minority shareholders would not be enough unless the lack of confidence springs from oppression of a minority by a majority in the management of the company's affairs, and such oppression must involve at least an element of lack of probity or fair dealing to a member in the matter of his proprietary rights as a shareholder. It is in the light of these principles that we have to consider the facts...with reference to Section 397.

5.3 The court also held that wide discretion is vested in the court to make order u/s 397. It held as follows:

The power conferred on the court to grant a remedy in an appropriate case

appears to envisage a reasonably wide discretion vested in the court in relation to the order sought by a complainer as the appropriate equitable alternative to a winding-up order. It is clear from these various decisions that, on a true construction of Section 397, an unwise, inefficient or careless conduct of a director in the performance of his duties cannot give rise to a claim for relief under that section. The person complaining of oppression must show that he has been constrained to submit to a conduct which lacks in probity, conduct which is unfair to him and which causes prejudice to him in the exercise of his legal and proprietary rights as a shareholder.

5.4 In *Sangramsinh P. Gaekwad and Others Vs. Shantadevi P. Gaekwad (Dead) thr. Lrs. and Others*, , the Supreme Court held that jurisdiction under this section is very wide. It was also cautioned as follows (paras 157-160 at page 441 of Comp LJ):

But, the same would not mean that Section 397 provides for a remedy for every act of omission or commission on the part of the board of directors. Reliefs must be granted having regard to the exigencies of the situation and the court must arrive at a conclusion upon analysing the materials brought on records that the affairs of the company were such that it would be just and equitable to order winding up thereof and that the majority acting through the board of directors by reason of abusing their dominant position had oppressed the minority shareholders. The conduct, thus, complained of must be such so as to oppress a minority of the members, including the petitioners, vis-a-vis the shareholders which a fortiori must be an act of the majority. Furthermore, the fact situation obtaining in the case must enable the court to invoke just and equitable rules even if a case has been made out for winding up for passing an order of winding up of the company; but such winding up order would be unfair to the minority members.

158. The interest of the company vis-a-vis the shareholders must be uppermost in the mind of the court while granting a relief under the aforementioned provisions of the Companies Act, 1956.

159. Mala fides, improper motive and similar other allegations, it is trite, must be pleaded and proved as envisaged in the Code of Civil Procedure. The acts of mala fides are required to be pleaded with full particulars so as to obtain an appropriate relief.

160. The remedy u/s 397 of the Companies Act is not an ordinary one. The acts of oppression must be harsh and wrongful. An isolated incident may not be enough for grant of relief and continuous course of oppressive conduct on the part of the majority shareholders is, thus, necessary to be proved. The acts complained of may either be designed to secure pecuniary advantage to the detriment of the oppressors or wrongful usurpation of authority.

5.5 So, it is the party who files the petition to prove that the materials brought on record that the affairs of the company is such that it would be just and

equitable to order winding up and there is oppression. Section 397 of the Companies Act is intended to avoid winding up and mitigate and alleviate oppression. Section 397 of the Act is geared to help the members who are oppressed whereas Section 398 comes into play in case of "mismanagement". Relief u/s 398 of the Act is to save the company if the affairs of the company are being conducted in a manner prejudicial to the company in the interest of the company as a whole and not to any particular member/members. To attract the section, there shall be continuing mismanagement. It is not necessary for the court to find out a case for winding up in case of mismanagement in order to grant relief. u/s 397, the power is of discretionary nature which enables the Company Law Board to make an order as it thinks fit with a view to bringing to an end the matter complained of as distinguished from the power granted u/s 398 which enables the Board to pass an order with a view to bringing an end or preventing the matters complained of or apprehended (see *Rajahmundry Electric Supply Corporation Ltd. Vs. A. Nageswara Rao and Others*, ; *Palghat Exports Private Ltd. and P. Ramkumar Vs. T.V. Chandran and Others*, . Very vast discretion is given u/s 402 to the Company Law Board to pass orders in case Sections 397 or 398 are alleged (see *Cosmosteels Private Ltd. and Others Vs. Jairam Das Gupta and Others*, .

6. To attract actions under Sections 397 and 398 of the Act in support of the finding of oppression and mismanagement, main reason stated is the convening of eleventh annual general body without proper notice. Now, we will analyse whether annual general body meeting was convened in violation of the statutory requirements. The 11th annual general body meeting was convened in pursuance of the decision of the board meeting held on 29.9.2005 at Casino Hotels Limited, Thrissur. In the board meeting held on 24.8.2005, item No. 4 reads as follows:

Notice of the next annual general meeting:

The draft notice for the next annual general meeting was read. The board then decided to hold the meeting on Thursday, the 29 September 2005 at 11.00 AM at Casino Hotels Limited, Trichur. The particulars as to date, place and time for the meeting was incorporated in the draft notice, and then it was approved, and Sri K.M. Mohandas, CMD, was authorized to sign the same.

6.1 The above board meeting was attended by the first petitioner in the company petition. Therefore, it cannot be stated that first petitioner and his supporters were not aware of the meeting. The Company Law Board held as follows:

The respondent No. 14, who has been apparently acting in association with the petitioner Nos. 1 to 4 in the affairs of the company and the respondent Nos. 6 to 9, reportedly, the neutral directors, participated in the annual general meeting held on 29.9.2005. The sequence of events would indicate that the petitioner Nos. 1 to 4 must be aware of the annual general meeting held on 29.9.2005. However, whether mere knowledge of the meeting would tantamount to serving notice in terms of Section 172 has to be considered. This section provides that

notice of every meeting shall be given, among others, to every member of the company whose name appears on its register of members. It is settled law that the provisions of Section 172 are mandatory and, must be strictly complied, non-compliance of which invalidates the resolutions passed thereon at the meeting. It is not that the petitioners dispensed with the need for being given any notice of the annual general meeting held on 29.9.2005. The respondents have produced certificates of posting to establish service of notice on petitioners and other shareholders. The certificate of posting, in the event of disputes among the parties, cannot amount to conclusive proof of service of notice on the addressees. It is not always safe to place reliance on mere certificate of posting, in the absence of any other corroborative evidence such as dispatch register, books of account, reflecting the expenses incurred in connection with sending of notices to the petitioners and other shareholders. It will only show that certain postal envelopes have been put into the post office and will not by itself necessarily mean that there has been service on the addressee concerned.

7. Section 172 of the Act reads as follows:

172. Contents and manner of service of notice and persons on whom it is to be served-(1) Every notice of a meeting of a company shall specify the place, and the day, and hour of the meeting, and shall contain a statement of the business to be transacted thereat.

(2) Notice of every meeting of the company shall be given-

(i) to every member of the company, in any manner authorised by Sub-sections (1) to (4) of Section 53; (ii) and (iii) not relevant.

(3) The accidental omission to give notice to, or the non-receipt of notice by, any member or other person to whom it should be given, shall not invalidate the proceedings at the meeting.

7.1 Notices were given under certificate of posting as provided u/s 53(1) and (2). Evidence for the same was also produced. Any accidental omission to serve the notice will not invalidate the meeting as provided u/s 172(3) of the Act. It is also pertinent to note that none of the shareholders including petitioners have got a case that they received empty postal envelope. First petitioner himself was a party to the board meeting wherein date, place and agenda, of the general body meeting were fixed. He cannot make a complaint along with his group that they did not receive notice of the meeting. In fact, respondent Nos. 5 and 14 (NRI directors) participated in the meeting and respondent No. 14 who was acting along with petitioner filed a civil case on the very same grounds. Section 172 is very clear that the obligation of the company is to give notice" in the manner as provided u/s 53(1) to (4). There is clear difference between "giving of notice" and "receipt of notice". In *Madhu v. Omega Pipes Ltd.* (1994) 1 ALT (CrI) 603 the scope and ambit of Section 138 Clauses (b) and (c) of the Negotiable Instruments Act were noted by the this court and Justice K.T. Thomas (as His Lordship was then) observed as follows:

In Clause (c) of the proviso the drawer of the cheque is given fifteen days from the date "of receipt of said notice" for making payment. This affords clear indication that "giving notice" in the context is not the same as receipt of notice. Giving is the process of which receipt is the accomplishment. The payee has to perform the former process by sending the notice to the drawer in his correct address, if receipt or even tender of notice is indispensable for giving the notice in the context envisaged in Clause (b) an evader would successfully keep the postal article at bay at least till the period of fifteen days expires. Law shall not help the wrongdoer to take advantage of his tactics. Hence the realistic interpretation for the expression "giving notice" in the present context is that, if the payee has dispatched notice in the correct address of drawer reasonably ahead of the expiry of fifteen days, it can be regarded that he made the demand by giving notice within the statutory period. Any other interpretation is likely to frustrate the purpose for providing such a notice.

7.2 The above passage was quoted with approval by the apex court in V. Raja Kumari v. P. Subbarama Naidu and Anr. (2005) 2 C LJ 20 (SC) : AIR 2004 SCW 6344. After noticing Section 27 of the General Clauses Act, it was also observed as follows at paragraph 14:

No doubt Section 138 of the Act does not require that the notice should be given only by "post". Nonetheless, the principle incorporated in Section 27 can profitably be imported in a case where the sender has despatched the notice by post with the correct address written on it. Then it can be deemed to have been served on the sendee unless he proves that it was not really served and that he was not responsible for such non-service.

7.3 In Black's Law Dictionary "giving of notice" is distinguished from "receiving of the notice":

A person notifies or gives notice to another by taking such steps as may be reasonably required to inform the other in the ordinary course, whether or not such other actually comes to know of it. A person "receives a notice when it is duly delivered to him or at the place of his business.

7.4 In Maxwell on Interpretation of Statutes, the learned author has emphasised that "provisions relating to giving of notice often receive liberal interpretation": vide page 99 of the 12th Edition. See also Basant Singh and Another Vs. Roman Catholic Mission, and M/s. Green View Radio Service Vs. Laxmibai Ramji and another, .

8. How notice should be given for annual general body meeting is provided in the Act: see Section 172(2) and Section 53 of the Act. Section 53(1) and (2) reads as follows:

53. Service of documents on members by company-(1) A document may be served by a company on any member thereof either personally, or by sending it by post to him to his registered address, or if he has no registered address in

India, to the address, if any, within India supplied by him to the company for the giving of notices to him.

(2) Where a document is sent by post,-

(a) service thereof shall be deemed to be effected by properly addressing, prepaying and posting a letter containing the document, provided that where a member has intimated to the company in advance that documents should be sent to him under a certificate of posting or by registered post with or without acknowledgment due and has deposited with the company a sum sufficient to defray the expenses of doing so, service of the document shall not be deemed to be effected unless it is sent in the manner intimated by the member, and

(b) such service shall be deemed to have been effected-

(i) in the case of a notice of a meeting, at the expiration of forty-eight hours after the letter containing the same is posted, and

(ii) in any other case, at the time at which the letter would be delivered in the ordinary course of post.

8.1 Here, company has proved by producing records to show that notices were sent by post. Since no counter evidence was adduced, statutory presumption u/s 53 will apply even though the above presumption is rebuttable. Whether addressee was able to rebut the presumption will depend upon facts of each case and burden is on the addressee to rebut the statutory presumption. Postal receipt with post office seal was produced to show that notice was sent to all shareholders by certificate of posting in the correct address as per the report. There is statutory presumption of service of notice, if it is served by post under certificate of posting in the correct address Section 53(2) after the expiry of 48 hours. A notice duly addressed and stamped and sent under certificate of posting is deemed to have been duly served. This view has been repeatedly followed by other courts in the following cases: see *Jadabpore Tea Co. Ltd. Vs. Bengal Doors National Tea Co. Ltd.*, and *Challa Rajendra Prasad Vs. Asian Coffee Limited*, .

9. The Hon'ble apex court in *M.S. Madhusoodanan v. Kerala Kaumudi (P) Ltd.* (2003) 4 Comp LJ 185 (SC) : AIR 2004 SC 904 held that the fact of posting has to be proved by the sender and that statutory presumption is only a rebuttable presumption. It is true that though Section 53 of the Companies Act uses the words "shall presume" it is a rebuttable presumption. Court can rely on the same only if it is proved that due posting of the document is proved. Once it is so proved, onus rests on the addressee to show that document referred to in the certificate of posting was not received by him. The apex court at paragraphs 121 and 122 held as follows:

121. Raising of a presumption, therefore, does not by itself amount to proof. The result of a mandatory requirement for raising a presumption cast on court, as there is u/s 53(2) of the Companies Act, is that burden of proof is placed on the person against whom the presumption operates for disproving it. It is only if such

person is unable to discharge the burden, that the court will act on the presumed fact: see *Dahyabhai Chhaganbhai Thakker Vs. State of Gujarat*, . A presumption, however, is of course not always rebuttable. But the mere use of the word "shall" before the word "presume" or other like word does not mean that the presumption is irrebuttable or conclusive. An ir-rebuttable presumption is couched in different language, normally, indicating that proof of one set of facts shall be "conclusive proof of a second set. An example of this is Rule 3 of the rules framed in 1956 u/s 18 of the Citizenship Act, 1955, which was the subject matter of challenge in *Izhar Ahmad's case Izhar Ahmad Khan Vs. Union of India (UOI)*, , A presumption has been defined as "an inference, affirmative or disnffirmative of the truth or falsehood of a doubtful fact or proposition drawn by n proress of probable reasoning from something proved or taken for granted": *Izhar Ahmad Khan v. Union of India AIR 1926 SC 1052, 1060-Editor. supra*. Section 53(2) contains no such language.

122. Consequently, the words "shall presume" in Section 53, Sub-section (2), means a rebuttable presumption which the court must raise provided the basic facts namely the due posting of the document is proved, the onus being on the addressee to show that the document referred to in the certificate of posting was not received by him.

9.1 Here, in this case, despatch of notice in time by certificate of posting was proved. In fact, the first petitioner himself was a party to the board meeting which decided the date, time and convening of the meeting as well as approval of the draft of the notice. 14th respondent who challenged the validity of the annual general body meeting by filing, a suit as well as fifth respondent who is also an NRI director and neutral directors attended the meeting.

10. In *Madhusoodanmi's case (2003) 4 Comp LJ 185 (SC)*, the apex court was considering the matter in a case where fraud was played to remove Shri Madhusoodanan from the board. Articles of association of that company were amended in 1973 to incorporate that "M.S. Madhusoodanan, presently the managing director and editor be and is hereby appointed the managing director and editor of the company for life or until he voluntarily retires on the existing remuneration". He was continuing as director for more than a decade. Thereafter, extraordinary general body meeting was alleged to be convened on 23.7.1986 wherein it was decided that C.N. Madhavi, Chairman, shall assume that executive powers of the managing director of the company and Madhusoodanan was ousted. Madhusoodanan and his children did not receive the notice. In another meeting, the share capital was increased to Rs. 20 lakhs and for 25 shares of Rs. 1,000 each and chairman was authorised to issue notices to the existing shareholders to apply for shares within seven days. According to Madhusoodanan, he was not informed about that offer of shares also. But, Madhusoodanan was also removed from the directorship. It was stated to be approved in the extraordinary general body meeting. Article 74 was deleted without even an agenda in the meeting which required an extraordinary

resolution. The apex court found that Article 49 which speaks of an accidental omission is not applicable to extraordinary general body meetings. At paragraph 96, it was affirmed by the apex court as follows:

96. The submission of the respondents that under Article 49 of the articles of association of the company even if no notice were given of the extraordinary general meeting, this would not vitiate proceedings is misconceived. This was no ordinary general meeting but a meeting where a special resolution was to be passed. This had to be done u/s 81 of the 1913 Act to which Article 49 is expressly subject and the requirement for giving due notice u/s 81 is mandatory.

Furthermore, Article 49 speaks of an "accidental omission" to give notice not officiating the proceedings; in other words the omission must be bona fide, and not an omission which was wilful be it was in this case.

10.1 Further, the court also found that, in that case, the evidence was not sufficient to prove that notice was effected. The finding was as follows at paragraph 95:

We are not satisfied that the service of the notice was effected either on Madhusoodhanan or any other shareholder in his group, including KIPL by either of the modes specified.

10.2 The company in that case did not record despatch of notice to any other shareholder. The court also took note that the despatch of notice was not proved and on the facts of the case, it was stated that the rebuttable presumption in service of notice to Madhusoodhanan and his group was shattered by the complainant, Madhusoodhanan. In this case, as we have already seen, there is sufficient material to hold that notices were sent by certificate of posting and all the six retiring directors submitted nominations including the first four petitioners and respondents 5 and 14 in pursuance of the notice and they cannot say that they have not received notices.

11. Another reason given by the Company Law Board is that only 40 out of 300 shareholders attended the meeting. Company Law Board found as follows:

The annual general meeting was convened on 29.9.2005 without serving proper notice on all the shareholders. As a result, there were only 40 members among 343 members participating in the annual general meeting. This shows that there can be no reason why if the other members had been served with notice of the meeting, they should fail to attend en bloc the meeting.

11.1 We are of the opinion that the above reasoning is also not well-founded. In most of the annual general body meetings of the public limited companies, many of the shareholders may not attend. Some of the shareholders may not be interested or supporting the majority shareholders. In previous annual general meeting also, number of attendance was below 35. As we have noted that NRI directors (respondents 5 and 14) and many neutral directors attended the meeting. Respondent No. 14 approached the civil court by filing OS No. 942 of

2005 questioning the validity of the annual general body meeting and issue of right shares. In the application for injunction, civil court ordered (order in IA No. 4727 of 2005) as follows:

The petitioner's case is that the annual general meeting held on 29.9.2005 is invalid because no proper notice was given to the petitioners and other NRI shareholders with regard to the meeting. The respondents produced documents which will prove that proper notice was served on all the shareholders with regard to the annual general meeting held on 29.9.2005. The respondents produced evidence to show that notice was served on the petitioner and all other shareholders with regard to the annual general meeting. That document was not disputed by the petitioners. Therefore, the averment that no notice was served on the petitioner and other shareholders does not stand for consideration. In the petition-it is stated that even though no notice was served the petitioner came to know about the annual general meeting held on 29.9.2005 and he attended the meeting. Then he came to know that eight new directors were appointed on that day. But the respondents produced documents which show that the petitioner and other NRI directors who retired by rotation submitted their nomination to be re-elected. The election also took place. The respondents produced the entire ballot papers used by the shareholders at the time of voting. Those documents were also not disputed by the petitioners and others. The documents produced by the respondents revealed that proper notice of the annual general meeting held on 29.9.2005 was given to the petitioner. The petitioner applied for re-election. The ballot papers show that the shareholders voted against the re-appointment of the petitioner and other NR1 directors. The other argument put forward by the petitioner's counsel is that 29.9.2005 was a general strike day and it prevented the members from attending the meeting. The respondents produced the attendance of the annual general meeting on 29.9.2005. It shows that 40 shareholders were present at the meeting. The respondents also produced the copy of the attendances and 10th annual general meeting of the respondent company which shows the presence of only 32 and 35 members at the previous annual general meetings.

11.2 Here, company had proved that notice was duly given and petitioners were not able to show the presumption as envisaged u/s 53 is broken. Therefore, annual general body-meeting was held with due notice and finding to the contrary is set aside.

12. The Company Law Board set aside election of respondents 16 to 23 as directors and it was further ordered that petitioners 1 to 4 and 5 and 14 shall be deemed to have been automatically re-appointed as directors of the eleventh annual general body meeting till the date of twelfth annual general body meeting. Main reason for setting aside the election of respondents 16 to 23 is the absence of valid notice for the general body meeting which is already held that the above finding is wrong. Second ground for setting aside the election of the directors is as follows:

There is no material on record disclosing the particulars of the directors, who were to retire by rotation at the annual general meeting on 29.9.2005 in terms of the relevant article. The notice dated 24.8.2005 convening the annual general meeting does not contain names of the directors who were to retire by rotation at the eleventh annual general meeting, unlike the notices issued for the earlier annual general meetings which contained the particulars of the retiring directors, their eligibility and willingness for reappointment ns directors of the company.

12.1 We have perused the notice of the annual general body meeting. In the notice dated 24.8.2005 calling the 11th annual general body meeting on 29.9.2005, seventh item of ordinary business as well as Explanatory Statement quoted by us (para-2) it can be seen that the names of the retiring directors were specifically mentioned. The names were also given in the report of the board of directors and sent along with the notice of annual general body meeting. First petitioner was present in the board meeting which approved the resolutions of the board meeting. Consequent on the receipt of notice, all the six retiring directors, first four petitioners and respondents 5 and 14, gave notice signifying their intention to contest. It shows that they were aware that they were retiring and contesting. u/s 257 of the Act, other shareholders who are retiring directors eligible for appointment as directors should give notice in the manner provided under the Act. Since eight other shareholders eligible for appointment applied within the time proscribed, notice was published in newspapers as provided u/s 257(1A) of the Act. Section 257(1A) of the Act reads as follows:

(1A) The company shall inform its members of the candidature of a person for the office of director or the intention of a member to propose such person as a candidate for that office, by serving individual notices on the members not less than seven days before the meeting:

Provided that it shall not be necessary for the company to serve individual notices upon the members as aforesaid if the company advertises such candidature or intention not less than seven days before the meeting in at least two newspapers circulating in the place where the registered office of the company is located, of which one is published in the English language and the other in the regional language of that place.

12.2 Accordingly, advertisement in Indian Express and Deepika which are having good circulation in the place where registered office of the company is situated was given. The names of the eight persons contesting in the election were given in the newspaper advertisement as provided u/s 257(1 A) and each of the directors was voted for or against by separate resolution. According to the Company Law Board, the minutes-book will not show that separate resolution was passed. By virtue of Section 256, each director shall be appointed by a separate resolution. The polling sheet produced would show that there was separate resolution for election of each directors and shareholders by separate ballot. Minutes book is only a summary of proceedings as can be seen from

Section 193 (2) of the Act.

13. Another ground taken for re-appointing the retired directors on the theory of "legitimate expectation" is more interesting. The Company Law Board observed as follows:

It is clear from the votes polled against re-appointment of the petitioner Nos. 1 to 4 that the second respondent failed to honour the understanding reached with the petitioners by exercising his vote and ensuring the votes of his family members in favour of the petitioners at the annual general meeting held on 29.9.2005. The petitioners admittedly have contributed huge sums of money without any yield for a decade. While the respondent Nos. 16 to 23, being children and close relatives of the second respondent became directors with meagre investments. This legitimate expectation of the petitioners from the second respondent and his family members did not materialise, unlike in the past several years. Consequently, the strength of NRI directors, after the annual general meeting, got reduced to three in number, while the strength of the directors belonging to the second respondent group increased from three to eleven numbers. The election of close kith and kin of the second respondent to the office of director, in complete exclusion of the petitioners who have been on the board admittedly since the year 1998, to my mind, is a visible departure from the standards adopted by the second respondent and his family members in offering directorship to those who contributed a minimum of Rs. 10 lakhs in case of doctors and Rs. 20 lakhs in case of others. This departure involving an element of lack of probity or fair dealing to the petitioners, in the matter of their proprietary or individual rights as shareholders, would constitute oppression.

14. We have also seen that out of the eight directors elected in the annual general meeting, six elected were not relatives or "kith or kin" of the chairman as observed by the Company Law Board. The CLB also relied on the decision of *Shanti Prasad Jain Vs. Kalinga Tubes Ltd.*, and *Suresh Chandra Manwaha v. Lauls (P) Ltd. and Ors.* (1978) 48 Comp Cas 110(AP) to set aside the election of the directors and re-appointing the directors on the ground of "legitimate expectation". In none of the above decisions, theory of legitimate expectation or promissory estoppel was relied on to set aside the election of new directors or for re-appointment of retired directors who failed in the election. Even though it was contended by the petitioners that when they invested they were promised that if the professional investors deposit rupees ten lakhs and non-professionals will deposit rupees twenty lakhs they will be offered directorship. Respondents categorically denied such agreement or understanding, either written or oral. Of course, it was true that when the company was made into a public limited company and petitioners 1 to 4 and respondents 5 and 14 were inducted as directors and then they were continuing. It is obligatory under the Companies Act and articles of association that one-third of the directors should retire in every board meeting and they are entitled to offer for re-election also. It is also pointed out that the chairman and his wife and children together

have invested about 40% of the shares amounting to more than rupees 3.5 crores and even according to the averment in the petition NRI directors have contributed only about 16% of the shares. The chairman and family have also stood personal guarantee to more than Rs. 21,99,00,000 whereas NRI directors have not stood personal guarantee for any loan. It is also submitted by the counsel for the appellant that out of the last 46 board meetings, petitioners have attended only seven board meetings. But, this is because they are residing abroad. But, by looking at the share capital, NRI directors are entitled to get only 3 or 4 directors out of 18 elected directors. It is submitted by the counsel for the appellant that they will maintain that ratio depending upon the share capital. That is recorded.

15. The doctrine of legitimate expectation has its genesis in the field of administrative law. Government and its departments, in administering the affairs of the country, are expected to honour their statements of policy. The apex court in *Navjyoti Co-operative Housing Society etc. Vs. Union of India and Others*, , after considering the House of Lords decision in *Council of Civil Service Unions v. Minister for the Civil Service* (1984) 3 All ER 935 held as follows:

It may be indicated here that the doctrine of "legitimate expectation" imposes in essence a duty on public authority to act fairly by taking into consideration all relevant factors relating to such "legitimate expectation". Within the conspectus of fair dealing in case of "legitimate expectation", the reasonable opportunities to make representation by the parties likely to be affected by any change of consistent past policy come in.

15.1 But, the above principle cannot be extended in company law. Doctrine of "legitimate expectation" is mostly confined to the right of a fair hearing before a decision which results in negating a promise or withdrawing of an undertaking. For getting the benefit of legitimate expectation, there should be a clear promise or a clear and unambiguous representation and burden of proof is on the person who claims the benefit on the basis of legitimate expectation. This principle that is applicable in administrative law is unknown in company law. In any event, in this case, it was not proved by the petitioners that there was any promise made by the chairman that they will continue as directors for ever because of their investment. As observed in *Union of India and others Vs. Hindustan Development Corpn. and others*, , legitimate expectation is not the same thing as anticipation. It is different from a mere wish or desire or hope and a mere disappointment would not give rise to legal consequences. The court observed as follows:

The legitimacy of an expectation can be intended only if it is founded on the sanction of law or custom or an established procedure followed in regular and natural sequence....Such expectation should be justifiably legitimate and protectable.

15.2 Quoting from *Attorney General for New South Wales v. Quin* (1990) 64 ALJ 36, the apex court observed as follows (para 30 at page 199 of Comp LJ):

To strike down the exercise of administrative power solely on the ground of avoiding the disappointment of the legitimate expectations of an individual would be to set the courts adrift on a featureless sea of pragmatism. Moreover, the notion of a legitimate expectation (falling short of a legal right) is too nebulous to form a basis for invalidating the exercise of a power when its exercise otherwise accords with law.

15.3 Even though legitimate expectation can be used as a substantial right against the public authorities with certain conditions, in this case, petitioners were unable to prove that the promoters gave them any promise at all even though they must have expected or wished a permanent berth in the board, but the retirement of one-third directors and their re-election is a statutory prescription and they were unable to prove that the promoters promised that they will vote always in their favour so that they will be re-elected. Even if the theory of "legitimate expectation" is applicable in company law, the burden of promise was not discharged by the petitioners.

16. For application of the doctrine of legitimate expectation, there should be ample proof that there is reasonable basis for legitimate expectation and it should not be against the statute: see also National Buildings Construction Corporation Vs. S. Raghunathan and Others, . Here, as per the statutory provisions (sections 255 and 256) and as per the articles of association (article 88), one-third of directors have to retire in every annual general body meeting; and it is for the shareholders to elect. The fact is that petitioners 1 to 4 and respondents 5 and 14 were retiring and their eligibility to re-election was mentioned in the notice of general body meeting. In fact, notice of annual general body meeting was approved in the director board meeting in which first petitioner was present. All the six submitted their nominations. Petitioners relied on the decision of the apex court in Dale and Carrington Invt. (P) Ltd. and Another Vs. P.K. Prathapan and Others, . There, the decision of this court (one of us, Justice J.B. Kohli, who wrote the judgment for the Division Bench), was approved by the Hon'ble Supreme Court. In that case, one Prathapan, an NRI, through his mother, induced one of his relative Ramanujam to promote a company by making initial investment of rupees five lakhs and the entire amount was given by Prathapan. But, later, showing that the company was running on loss and Ramanujam advanced money it was manipulated that a sum of Rs. 6,86,500 was standing to the credit of Ramanujam and the board of directors in its meeting held on 24.10.1994 chaired by Ramanujam decided to issue 6,865 equity shares of Rs. 100 each in his favour and Prathapan was not intimated about the meeting. By reason of the said act, Prathapan who was a majority shareholder in the company was reduced to minority. Ramanujam did not contribute any money from his own resource for starting a company and he was drawing salary for working as managing director. The charge of oppression and mismanagement by Ramanujam was accepted by the Company Law Board, but, the relief granted to Prathapan was only to sell his shares at par to Ramanujam even though by that time the company had assets worth million. This court, on

the facts of that case, held that fraud was played by Ramanujam and the entire matter was done behind the back of the principal shareholder who raised the entire company. The Supreme Court approved the same and it was held as follows:

15. The fiduciary capacity within which the directors have to act enjoins upon them a duty to act on behalf of a company with utmost good faith, utmost care and skill and due diligence and in the interest of the company they represent. They have a duty to make full and honest disclosure to the shareholders regarding all important matters relating to the company. It follows that in the matter of issue of additional shares, the directors owe a fiduciary duty to issue shares for a proper purpose. This duty is owed by them to the shareholders of the company. Therefore, even though Section 81 of the Companies Act which contains certain requirements in the matter of issue of further share capital by a company does not apply to private limited companies, the directors in a private limited company are expected to make a disclosure to the shareholders of such a company when further shares are being issued. This requirement flows from their duty to act in good faith and make full disclosure to the shareholders regarding affairs of a company. The acts of directors in a private limited company are required to be tested on a much finer scale in order to rule out any misuse of power for personal gains or ulterior motives.

16.1 Here, in this case, right issue of shares was offered by the reconstituted director board to all the shareholders in proportion to their holdings and not to chairman or his relatives or directors only. We shall deal with the question of issue of right shares later. It is not laid down by the Supreme Court in Dale and Carrington's case (2004) 4 Comp LJ 1 (SC) because of the initial investment made by some of the directors they cannot be changed at all. The apex court in Sangramsinh P. Gaekwad and Others Vs. Shantadevi P. Gaekwad (Dead) thr. Lrs. and Others, observed as follows:

67. The ratio in Sangramsinh P. Gaekwad and Others Vs. Shantadevi P. Gaekwad (Dead) thr. Lrs. and Others, thus, must be understood to have been rendered in the fact situation obtaining in that case. It does not lay down a law that fiduciary duty of a director to the company extends to a shareholder so as to entitle him to be informed of all the important decisions taken by the board of directors. Such a broad proposition of law, if understood to have been laid down in Dale and Carrington would be inconsistent with the duty of a director vis-a-vis the company and the settled law that the statutory duty of a director is primarily to look after the interest of the company.

16.2 As mentioned in Palmer's Company Law, director's fiduciary duty is with the company and not with individual shareholder and there is no agency relationship with shareholder and directors. But, directors shall not misrepresent and they should act bona fide in the best interest of the company: see Palmer's Company Law, 23rd Edition, Chapter 64, pages 848 to 850. In Rolta India Ltd. and another Vs. Venire Industries Ltd. and others, , a Division Bench of the

Bombay High Court held that powers of directors to manage the company cannot be curtailed by shareholders' agreement. Here, in this case, there was full disclosure and retirement of one-third directors and election to that place is in accordance with the Act and articles of association and theory of "legitimate expectation" has no application.

17. But, we are of the opinion that election of eight directors in the annual general body meeting is vitiated on other infirmities. As we have seen that in the notice of annual general body meeting agenda item No. 7 of ordinary resolution is to appoint directors in the place of those retiring by rotation and names of six persons were also mentioned in the explanatory note, but nowhere in the notice it is stated that eight directors will be elected. Going by the agenda, only six directors can be elected. Here, 8 directors were elected against the proposal in the agenda. According to the appellant, none of the shareholders attended the meeting objected to the election of eight directors and no complaints of any absentee shareholders were made that if such an agenda was there, they would have attended the meeting. I however, election of eight directors in the meeting convened without a specific agenda is a technical irregularity even if it is not done intentionally. Apart from the above, it is not stated in the notice that six retiring directors are offering themselves for reappointment even though it is stated in the explanatory note that they are eligible for re-election. It is true that they signified assent for contesting again only when they received notice. In fact, the definite case of the company was that when 8 other shareholders signified assent, they published notice in one English and in one vernacular newspaper, having good circulation in the area where the registered officer of the company is situated. The notice published was as follows:

Notice is hereby given u/s 257(1A) of the Companies Act, 1956 that the following persons have left at the office of the company notices in writing under their respective hands signifying their candidatures for the office of directorships in the company along with deposits of Rs. 500.00 each. As such, these persons are eligible for being appointed as directors, if so resolved by the forthcoming annual general meeting. Dr. U.K. Gopalan, Dr. Deni Mohan, R. Raghunandan, K.S.R. Chandran, Anirudhan P.A., Adv. M.G. Rajeev, Dr. M.G. Subramonian, Dhanesh Mohan.

17.1 The names of eight persons were absent in the notice calling for general body meeting as they submitted their willingness after the issuance of the notice. Similarly, six retiring directors also submitted willingness after issuance of notice, but, in the notice advertised in newspapers, it is not mentioned that six retiring directors are also contesting. It is true that statutory obligation to publish names of contestants u/s 257(1A) is only when shareholders other than retiring directors file nomination as provided u/s 257(1). Section 256 also gives indication that for the retiring director to get re-appointed need not file nomination; and automatically, he is a candidate and if there is no contestant, they can be re-appointed without polling. In the absence of election or re-

appointment in the adjourned meeting, re-appointment can be deemed to be made u/s 256(4)(b) unless their unwillingness is notified in writing. But, even though there is no statutory obligation, in fairness, since eight shareholders have decided to contest and polling became a necessity, when newspaper advertisement was made with regard to eight shareholders who are contesting, the fact that retiring directors are also offering themselves for re-appointment could have been mentioned. In any event, election of eight directors in the annual general body meeting held on 29.9.2005 is irregular due to technical reason that as per the agenda only six directors can be elected. We are of the opinion that setting aside the election of eight directors by the Company Law Board needs no interference though on different grounds, but, order of the Company Law Board regarding re-appointment of retiring directors is incorrect. Directors retiring by rotation at the annual general body meeting cannot continue in office after the last date on which annual general body meeting is required to be held u/s 166(1) of the Act: see *A. Ananthalakshmi Ammal and Another Vs. The Indian Trades and Investments Ltd. and Another*, . See also *Gore-Browne on Companies* 44th Edition, 1986, paragraph 25-16. In other words, retiring directors will retire on the deemed date of annual general body meeting whether meeting is held or not (see Section 255), unless they are re-appointed in the manner provided u/s 255 or 256 or by the articles of association. Here, six directors retired by rotation and they were not re-appointed in the annual general body meeting and, therefore, order of the Company Law Board re-appointing them is illegal.

18. Next question is whether setting aside of special resolution to give shares to outsiders after issuance of right shares is correct? It is true that special resolution was placed before the general body. It requires two-thirds majority. It was not passed, but it was also recorded that majority shareholders expressed the view that right shares should be issued before issuing shares to public. Special resolution as mentioned in item No. 2 in the notice is as follows:

2. To consider, and if thought fit, to pass the following resolution as a special resolution:

RESOLVED THAT consent of the company be and is hereby accorded u/s 81(1A) of the Companies Act, 1956 to offer or issue any number of shares in the authorized capital of the company to any person(s) whether or not those person(s) include the members of the company or not, in such manner and subject to such terms and conditions as the Board may, in the absolute interest of the company, deem fit.

18.1 The minutes recorded was also quoted by us in para 7. We are of the opinion that the Company Law Board was right in holding that special resolution was not passed. It is not recorded in the meeting that there is two-thirds majority. But, the word "majority" is mentioned. Without passing a special resolution by two-thirds majority shares cannot be offered to outsiders. Finding of the Company Law Board that special resolution was not passed according to

law, needs no interference.

19. Whether issuance of right shares -is correct is the next question to be considered. The Company Law Board set aside the decision to issue right shares and held that it is illegal and void. The Company Law Board accepted the decision of the general body meeting for the increase in the share capital. The petitioners did not challenge the above decision. For increase in share capital of the company, only ordinary resolution is required as provided u/s 94(1). If share capital is increased, the board of directors can decide the question of issuance of right shares (section 81). A special resolution is necessary in the general body meeting only for issuance of shares to outsiders in view of Section 81(1A) of the Act. Accordingly, right shares were offered. Petitioners were also offered right shares at the ratio of 1:4. All the shareholders were given equal right to get right shares at the same ratio. Further, issue of shares by right issue is made by the board meeting on 15.10.2005 offering shares to all existing shareholders on the ratio of 1:4 at face value. There was no discrimination. Share ratio of minority shareholders will not change. Letters are issued to all the shareholders under certificate of posting. IA No. 4727 of 2005 in OS No. 942 of 2005 was filed by 14th respondent who supported the petitioner in the company petition in all respects to restrain the company from issuing right shares. Civil court did not find any fault in issuance of right shares. Civil court also recorded the undertaking given by the company that they will give three months' time to NRI shareholders as the plaintiff wanted time to consult other NRI shareholders. Board decision dated 23.1.2006 shows that even though the company has raised about Rs. 95 lakhs through right issue, actual share allotment was not able to be made because of the orders of the court or Company Law Board. There was delay in actual issuance of shares because of the stay order passed in LA. No. 4727 of 2005. On 26.10.2005, Company Law Board passed ex parte interim order prohibiting the company from issuing further shares. It was modified on 13.2.2006 permitting the issue of right shares subject to the finality of the company petition. Accordingly, on 14.2.2006, share transfer committee met and issued right shares subject to the decision of the Company Law Board. The Company Law Board stayed the order on 15.2.2006. From the order, Company Appeal No. 5 of 2006 was filed. It was informed to this court that shares were already allotted. Hence, it was ordered that shares issued or allotted shall be subjected to the final order passed by Company Law Board and company petition was directed to be heard. Supreme Court in the SLP directed the Company Law Board to pass orders. Here, only question to be considered is whether order of Company Law Board regarding issue of right shares is correct or not? On 15.10.2005, when board decided to offer right shares to all shareholders without discrimination on the same proportion depending on their holding, there was no stay of any kind. The share transfer committee allotted the shares and actual allotment was made when there was no stay. In any event, question to be decided is whether issue of right shares in the same proportion to all shareholders when finance was urgently required is an act of oppression or

mismanagement. The Company Law Board issued interim order on 13.2.2006 to issue right shares and keep the shares of petitioners pending subject to finality of company petition. It is offered by the counsel for the appellant that NRI shareholders can still accept the offer of shares within a reasonable time so that voting pattern will not change. They cannot insist that they will not further invest, but, shall be a permanent direction. The fact that the company was in need of urgent finance is not disputed. Even in the board meeting held prior to the annual general body meeting wherein first petitioner was also present, there was a proposal to accept two shareholders from outside with Rs. 50,00,000 each as requirement of finance is undisputed. But, for issuance? of shares to outsiders, special resolution was necessary u/s 81(1A), but, special resolution was not passed legally. Since the director board has power to issue right shares without exceeding the authorised capital, the decision to issue right shares cannot be set aside unless there is lack of bona fides. There is no mala fides or lack of bona fides in the decision of issuance of right shares to all existing shareholders in the same proportion. In A.C. Ananthaswamy and Others Vs. Boraiah (dead) by LRs., , the apex court held that the level of proof required for proving fraud is extremely high: see also Maharashtra Power Development Corporation Ltd. v. Dabhol Power Co. (2004) 3 Comp LJ 58 (Bom). The apex court in Sangramsinh P. Gaekwad's case, supra, held as follows:

64. It is also interesting to note that while applying the "extraneous purpose test" or "ulterior motive test", the court noticed *Piercy v. S. Mills and Co. Ltd.* wherein it was held:

The basis of both cases is, as I understand, that directors are not entitled to use their powers of issuing shares merely for the purpose of maintaining their control or the control of themselves and their friends over the affairs of the company, or merely for the purpose of defeating the wishes of the existing majority of shareholders.

19.1 The expression "merely" assumes significance.

65. Significantly, in *Needle Industries*" case (1982) 1 Comp LJ 1 (SC), it was categorically held that the directors have power to issue shares at par even if their market price is higher, being primarily a matter of policy (see para-120).

19.2 Court also found that "proper purpose" doctrine and doctrine of "fairness" shall be considered vis-a-vis the doctrine of "bona fides". Here, since right issues were offered to all existing shareholders in equal proportion, there is no question of mala fides or acts of fraud, etc. But, that non-passing of a special resolution u/s 81(1A) is necessary only for issuance of shares to outsiders and not for issuance of right shares to the existing shareholders which is covered by Section 81 and since right shares were issued in the same proportion, it cannot be stated that by issuance of right shares there is any oppression or mismanagement. In *Needle Industries (India) Ltd. and Others Vs. Needle Industries Newey (India) Holding Ltd. and Others*, , it was held that directors have absolute power to issue

right share provided they are acting under good faith. It was held as follows:

Where directors of a company seek, by entering into an agreement to issue new shares, to prevent a majority shareholder from exercising control of the company, they will not be held to have failed in their fiduciary duty to the company if they act in good faith in what they believe, on reasonable grounds, to be the interests of the company. If the directors' primary purpose is to act in the interests of the company, they are acting in good faith even though they also benefit as a result.

19.3 After considering *Needle Industries (India) Ltd. and Others Vs. Needle Industries Newey (India) Holding Ltd. and Others*, the apex court in *Sangramsinh P. Gaekwad's case* (2005) 3 Comp LJ 385 (SC), *supra*, observed as follows:

If the shares are issued in the larger interest of the company, the decision to issue shares cannot be struck down on the ground that it has incidentally benefited the directors in their capacity as shareholders.

20. But, in this case, election of eight directors was already set aside by the Company Law Board and that board decided to issue right shares. Whether that is a reason for setting aside the issue of right shares is the next important question to be considered in this case. Merely because election of some of the directors were set aside subsequently, the decision taken by the director board earlier will not become invalid. In this case, there were 20 directors in the board. Election of 8 directors was set aside subsequent to board decision to issue right shares. Section 290 of the Companies Act reads as follows:

290. Validity of acts of directors—Acts done by a person as a director shall be valid, notwithstanding that it may afterwards be discovered that his appointment was invalid by reason of any defect or disqualification or had terminated by virtue of any provision contained in this Act or in the articles:

Provided that nothing in this section shall be deemed to give validity to acts done by a director after his appointment has been shown to the company to be invalid or to have terminated.

20.1 Article 96 of the articles of association of the company also says as follows:

All acts done by any meeting of the Board or of a committee thereof or by any person acting as a director, shall, notwithstanding that it may be afterwards discovered that there was some defect in the appointment of any one or more of such directors or of any person acting as aforesaid or that they or any of them were disqualified, be as valid as if every such director or such person had been duly appointed and was qualified to be a director.

20.2 As we have already seen—the Company Law Board itself accepted the decision to increase share capital. The special resolution to issue shares to outsiders was not passed legally even though there was a general opinion that it

should be offered first to the shareholders itself. But, what was decided by the board meeting was to issue right shares in equal proportion to all including the NRI directors. We have already seen that a civil court in the interim application held that issuance of right shares and election to the board was correct. However, considering the request of NRI directors, 3 months time was allowed to accept offer of right shares and on the basis of the civil court order, right shares were issued after three months. Therefore, it cannot be slated that right shares were issued or decided to issue with any mala fide intention or it affected anybody's right. It is a bona fide, decision taken in good faith as finance was required urgently for modernisation. In view of the pendency of cases, the above offer of issue shares to all the shareholders can be extended by another one month from today. Therefore, no prejudice is caused. It is true that object of Section 290 is to protect persons dealing with the company. Outsiders as well as shareholders are protected by providing that acts done by a person as a director shall be valid although their appointment was declared subsequently as invalid. Mainly, this protection is for the outsiders, but, a shareholder also cannot be taken aback by setting aside a decision of the board done in good faith merely because election of some of the directors were set aside subsequently. The acts of a de facto director are treated as valid both vis-a-vis members. In *Kanssen v. Rialto (West End.) Ltd.* (1945) 15 Comp Cas 23(SC), Lord Greene M.R., while dealing with Section 143 of the Companies Act, which reads, "the acts of a director or manager shall be valid notwithstanding any defect that may afterwards be discovered in his appointment or qualification", decided that the section will protect the acts even though the parties concerned knew the facts, but were not conscious of the defect. It is true that if there is no appointment at all, the section will not be applicable: see *Morris v. Kanssen* (1946) 16 Comp Cas 186(SC). But, here, there was appointment of eight directors and they were elected by the majority of shareholders attending the annual general body meeting, even though their appointment was found to be defective or irregular. In *Shiromani Sugar Mills Ltd. Vs. Debi Prasad*, it was held by the Allahabad High Court that forfeiture of shares made by the directors who continued to act even after they were disqualified, but, were not aware of the same, are saved by Section 290. In this connection, we also refer the decision in *Probodh Chandra Mitra Vs. Road Oils (India) Ltd. and Others*.

21. At the time when it was decided to issue right shares, the directors were not disqualified. The shareholders who are not members of the board also acted on the resolution. Many such shareholders like petitioners in Company Appeal No. 17 of 2006, etc., accepted the offer of shares and invested money. Here, decision to issue shares was taken on 13.10.2005; and no director has complained that there was no notice to that board meeting. Right shares were offered to all shareholders in the same proportion without any discrimination. It is not for the benefit of the directors only, but for the benefit of the company for overcoming the financial crunch decided in good faith in the interest of the company. The fact that the company required heavy investment for modernisation and for installing

new equipments, clear the bank dues, etc., etc., are not disputed. In these circumstances, we are not setting aside the issue of right shares and we hold that the decision of the Company Law Board in setting aside the decision to issue right shares is not correct. However, we are of the opinion that one month's time from today should be allowed to the NRI shareholders/petitioners to accept or reject their right shares so that they can maintain the share ratio, if they want.

22. The Company Law Board also set aside the issue of duplicate shares to Purushothaman and transfer of shares. In fact, that decision was not challenged by any of the petitioners. The decision was taken by the board of directors to issue duplicate shares in place of lost shares. Transferring the shares of Purushothaman was approved in the same board wherein first petitioner attended. By no stretch of imagination, it can be stated that the above issuance of duplicate shares or transfer of shares was illegal. Duplicate shares were issued on receipt of indemnity bond as provided u/s 84(2). Indemnity bonds and documents produced would show that share transfer was also effected validly. Decision to issue duplicate shares to Purushothaman and transfer of the same were not challenged in the petition. Therefore, the relief granted by the Company Law Board in this regard also cannot be accepted.

23. With regard to acts of mismanagement alleged regarding the arrangement with special investigating centre, the agreement with the special investigating centre was made when petitioners 1 to 4 as well as their supporting NRI directors were in the board; and they cannot press that point to get relief u/s 398 as they were in management. However, we are of the opinion that if any amount is due from special investigating centre that should be realised by the company; and the company auditor should go through the agreement with the special investigating centre and also the accounts specifically on this aspect and submit a report pointing out whether any amounts by way of percentage of profit or rent has to be received from the centre, etc., and their report should be placed before the board after the next annual general body meeting and the board should take appropriate action on the report. In the result, all the appeals are allowed partly and the order of the Company Law Board is partly set aside. We hold that the general body meeting was held with valid notice. Issuance of right shares needs no interference and Company Law Board went wrong in setting aside the issue of duplicate shares to Purushothaman and subsequent transfer of his shares. We also hold that re-appointment of the retired directors after the date fixed for annual general body meeting, is not correct and that part of the decision is set aside. But, we hold that CLB is right in setting aside the election of eight directors (though for other reasons mainly for technical irregularity) and special resolution u/s 81(1A) to issue shares to the public. We order that petitioners and other NRI shareholders shall be given one months time from today to accept the right shares offered, and it is for them to accept the offer or not. As offered by the counsel appearing for the company and Chairman, NRI directors also will be re-appointed to the board in proportion to their shareholdings as on the date of next annual general meeting to be conducted

after the expiry of 30 days from today. Company Law Board directed that next annual general body meeting shall be held on 30.9.2006. It is stated that it was not conducted due to pendency of the case. Therefore, it shall be positively conducted on or before 30.12.2006. In conducting the 12th annual general body meeting, procedure suggested by the Company Law Board shall be complied with and directions in paragraph 7 II, IV, V, VI and VII are not interfered with. Till next general body meeting is held, no policy decision shall be taken by the board.