CASE LAW ANALYSIS

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Director's liability for cheque bouncing : Whether directors alone can be prosecuted sans the company

Himanshu v. *B. Shivamurthy* [2019] 213 Comp Cas 16 (SC)

A provision contained in section 141 of the Negotiable Instruments Act, 1881, which is found in innumerable statutes in India being a Standard Penal Provision (SPP) making every person in charge of and responsible to the company for the conduct of its business vicariously liable the offence for which the company is primarily liable.

The SPP has two parts. The primary liability for an offence is against the company as such. Once the allegation against the company is levelled and established, then by virtue of the legal fiction, every person (whether a director or not) in charge of and responsible to the company for the conduct of its business is, in the eye of law, deemed as much guilty of the offence as the primal offending company. The defaulting company is always liable for the commission of any offence and there is nothing in the section to excuse the company from the penalties imposed by the law[2]. The two parts of sub-section (1) of the SPP are joined by the conjunction "as well as", meaning that for an offence of the company both the person concerned and the company will be proceeded against and might be punished.

In *State of Madras* v. *C. V. Parekh* [1971] Cri. LJ 418 (SC), it was urged that the managing director and the manager were in charge of and responsible to, the company for the conduct of the business of the company and, consequently, they must be held responsible for a contravention and hence liable to be punished under the SPP. The Supreme Court, dealing with this argument remarked that argument could not be accepted because it ignored the first condition for the applicability of section 10 to the effect that the person contravening the order issued under the said Act must be a company itself.

1. Practising Company Secretary, Past President, the Institute of Company Secretaries of India.
2. *State* v. *S. P. Bhadani*, AIR 1959 Patna 9.

This controversy was taken up to the Supreme Court in a latter case[1], in which the Supreme Court explained the above decision and held that the directors or officers of a company can be independently prosecuted without prosecuting the company, as the section, in the opinion of the court, is plain enough. The company alone may be prosecuted. The person-in-charge only may be prosecuted. The conniving officer may individually be prosecuted. One, some or all may be prosecuted. There is no statutory compulsion that the person-in-charge or an officer of the company may not be prosecuted unless he be arraigned along-side the company itself. However, before the person-in-charge or an officer of the company is held guilty in that capacity it must be established that there has been a contravention of the order by the company. That should be axiomatic and that is all that court laid down in *State of Madras* v. *C. V. Parekh* [1971] Cri. LJ 418 (SC) as a careful reading of the case will show and not that the person-in-charge or an officer of the company must be arraigned simultaneously along with the company if he is to be found guilty and punished.

Three categories of persons who are brought within the purview of the penal liability through the legal fiction envisaged in the SPP are : (1) the company which committed the offence, (2) everyone who was in charge of and was responsible for the business of the company, (3) any other person who is a director or a manager or a secretary or officer of the company, with whose connivance or due to whose neglect the company has committed the offence[2].

Under the SPP the company as well as every person who at the time of the offence was committed was in charge of and was responsible to the

1. *Sheoratan Agarwal* v. *State of Madhya Pradesh* [1984] 4 SCC 352 ; AIR 1984 SC 1824. See also *Shrenkiraj* v. *Labour Officer* [1986] 60 Comp Cas 658 (Karn) ; *T. P. Singh Kalra* v. *Star Wire India Ltd.* [1998] 93 Comp Cas 186 (P&H). There are, however, decisions wherein the High Courts have held contrary to the aforecited rulings. This happened because in these cases the Supreme Court ruling in *Sheoratan Agarwal's* case (supra) was not brought to the notice of the learned judges—see *V. B. Sivalingam Chettiar* v. *Labour Officer* [1986] 59 Comp Cas 701 (AP) ; *Vidyawati* v. *State* [1988] 3 Comp. LJ 117 (Delhi) ; *M. L. Lakhotia* v. *State* [1983] 3 Comp. LJ 114 (Delhi) ; [1989] 66 Comp Cas 118 (Delhi) ; *Narinder Singh* v. *State of Punjab* [1998] 92 Comp Cas 957 (P&H) ; *Krishan Bai* v. *Arti Press* [1994] 80 Comp Cas 750 (Mad) and *Anandan* v. *Arivazhagan* [1999] 96 Comp Cas 503 (Mad).
2. *Anil Handa* v. *Indian Acrylic Ltd.* [2000] 99 Comp Cas 36 (SC). In this case the Supreme Court has extensively dealt with the decision in *U. P. Pollution Control Board* v. *Modi Distillery* [1988] 63 Comp Cas 77 (SC) the observations in that case that, "It is true that there can be no vicarious liability of the chairman, vice-chairman, managing director and members of the Board, unless the owing the industrial unit, is prosecuted", were obiter. This decision of the apex court has set at rest the controversy as to whether prosecution of a company under the SPP is a must to prosecute directors and officers of the company. See also *Alex* v. *Vijayan* [1994] 81 Comp Cas 910 (Ker).

company, for conducting its business, shall be deemed to be guilty as also the company itself, of the offence and both of them shall be liable to be proceeded against and punished accordingly ; both are liable for punishment. Therefore, their liability is independent. Each of them is independently liable for punishment. When the liability is of each one of them it is perfectly permissible that both can be prosecuted jointly or only one can be prosecuted or both can be prosecuted (*R. Ramchandran* v. *Yeram Sesha Reddy* [1999] 96 Comp Cas 830 (AP) ; *L. Raja Krishna Reddy* v. *Satwik Drugs Ltd.* [1999] 96 Comp Cas 891 (AP) ; *K. S. Subbaraman* v. *Iyyammal* [2000] 100 Comp Cas 177 (Mad). See also *Anand* v. *S. M. Thomas* [2001] 105 Comp Cas 406 (Mad) and *O. N. Phadnish* v. *Radhakrishnan* [2001] 105 Comp Cas 210 (Mad)).

The decision in *Sheoratan Agarwal* v. *State of Madhya Pradesh*[1] came to be overruled by a three-Judge Bench of the Supreme Court in *Aneeta Hada* v. *Godfather Travels and Tours P. Ltd.* [2012] 172 Comp Cas 75 (SC), while the decision in *Anil Hada* v. *Indian Acrylic Ltd.* [2000] 99 Comp Cas 36 (SC), has been partly overruled. With regard to section 141 of the Negotiable Instruments Act, 1881 the Supreme Court declared that under the SPP directors/officers of a company cannot be prosecuted without prosecuting the company ; arraigning a company as an accused is a condition precedent for their prosecution. In the Supreme Court's view, section 141 of the 1881 Act is concerned with the offences by the company ; it makes the other person vicariously liable for commission of an offence on the part of the company. The vicarious liability gets attracted when the condition precedent under section 141, namely, offence by company stands satisfied. The power of punishment is vested in the Legislature and that is absolute in section 141 which clearly speaks of commission of offence by the company. The liability created is penal and thus warrants strict-construction. It cannot therefore be said that the expression "as well as" in section 141 brings in the company as well as the director and/or other officers who are responsible for the acts of the company within its tentacles and, therefore, a prosecution against the directors or other officers is tenable even if the company is not arraigned as an accused. The words "as well as" have to be understood in the context. Applying the doctrine of strict construction, it is clear that commission of offence by the company is an express condition precedent to attract the vicarious liability of others. Thus, it is absolutely clear that when the company can be prosecuted, then only the persons mentioned in the other categories could be vicariously liable for the offence subject to the averments in the petition and proof thereof. It necessarily follows that for

1. See AIR 1984 SC 1824.

maintaining the prosecution under section 141 of the 1881 Act, arraigning of a company as an accused is imperative only then the other categories of offenders can be brought in the dragnet on the touchstone of vicarious liability as the same has been stipulated in the provision itself.

In *Anil Gupta* v. *Star India P. Ltd.* [2014] 185 Comp Cas 251 (SC) once again the Supreme Court reiterated that the company not being a party to the proceedings under section 138 read with section 141 of the Act, the proceedings against the appellant could not be continued in the absence of the company.

In the case in hand, once again, the Supreme Court dealt with the abovementioned controversy. The Supreme Court held, following the *Aneeta Hada* v. *Godfather Travels and Tours P. Ltd.* [2012] 172 Comp Cas 75 (SC), that the provisions of section 141 postulate that if the person committing an offence under section 138 is a company, every person, who at the time when the offence was committed was in charge of or was responsible to the company for the conduct of the business of the company as well as the company, shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished. In the absence of the company being arraigned as an accused, a complaint against the appellant was not maintainable.

Regarding the GPP, the general principle is that a company has been made primarily liable, but to make any person vicariously liable, it has to be shown that such person was in charge of or was responsible for the conduct of its business. In the absence of a mention in the complaint as to how the accused persons were concerned in the carrying on of the day-to-day business of the company, the complaint would not taken cognizance of.

Many prosecutions under the above penal provision fail at the entry level because the complaint filed in the criminal court does not identify a person who was in charge of and responsible to the company for the conduct of its business when the offence took place. In other words, and it does not "aver" as to who such person is why he is to be regarded as a person who was in charge of and responsible to the company for the conduct of its business. This negligence occurs despite that in several cases the courts have repeatedly said so and dismissed complaints on the threshold of the stage of taking cognizance of the offence alleged to have been committed by the company.

In its landmark judgment (*National Small Industries Corp. Ltd.* v. *Harmeet Singh Paintal* [2010] 154 Comp Cas 313 (SC)), the Supreme Court has held that the persons who are sought to be made vicariously liable for a criminal offence under section 141 of the Act should be, at the time the offence was committed, in charge of, and responsible to the company for the conduct of the business of the company. Every person connected with the company shall not fall within the ambit of the provision. Only those persons who were in charge of and responsible for the conduct of the business of the company at the time of commission of an offence will be liable for criminal action. A director of a company who was not in charge of and was not responsible for the conduct of the business of the company at the relevant time, will not be liable for a criminal offence under the provisions. The liability arises from being in charge of and responsible for the conduct of the business of the company at the relevant time when the offence was committed and not on the basis of merely holding a designation or office in a company.

The Supreme Court pointed out (page 320 of 154 Comp Cas) :

> "A company may have a number of directors and to implead any or all the directors as accused in a complaint merely on the basis of a statement that they are in charge of and responsible for the conduct of the business of the company without anything more is not a sufficient or adequate fulfilment of the requirements under section 141. For making directors liable for the offences committed by the company under section 141 of the Act, there must be specific averments against the directors, showing as to how and in what manner the directors were responsible for the conduct of the business of the company."

Where a director or officer of a company is sought to be made liable for an offence for which the company is primarily responsible, it is incumbent for the complainant firstly to make specific allegation and secondly to establish the offence by cogent evidence ; else the complaint is likely to meet with dismissal as has happened in *V. P. Shrivastava* v. *Indian Explosives Ltd.* [2010] 159 Comp Cas 529 (SC).

With regard to a criminal complaint under sections 406, 420 and 120B of the Indian Penal Code, 1860, read with sections 540 and 542 of the Companies Act, 1956, against the appellants (senior employees of a company) on the allegation that at the time of entering into an agreement with the complainant company, they, by having suppressed the fact that the company was likely to be declared a sick company and was, in fact, declared to be so by the BIFR, had the dishonest intention to induce the complainant to enter into the agreement, which amounted to cheating. Allowing the employees' appeals, the Supreme Court held that there was not even a whisper let alone a specific averment that the appellants had dishonestly "induced" IEL to enter into the agreement. On the contrary, the complaint clearly revealed that IEL was fully conscious of the precarious financial health of FCIL at the time it had decided to enter into contract with FCIL and BCCL to ensure a regular supply of its basic raw material from FCIL so that its production of explosives did not suffer. A mere mention of the words "defraud" and "cheat" in the complaint was not sufficient to infer that the appellants had dishonest intention right at the beginning when, demonstrably, after due deliberations a tripartite agreement was signed, which, under the given circumstances at that juncture, was considered to be in the interest of all the three parties to the agreement. There was nothing in the complaint which might suggest that the complainant had entrusted any property to the appellants or that the appellants had dominion over any of the properties of the complainant, which they dishonestly converted to their own use so as to satisfy the ingredients of section 405 of the Indian Penal Code, 1860, punishable under section 406 of the Indian Penal Code, 1860. Therefore the question of alleged conspiracy between the appellants did not arise.

In another case, *Maharashtra State Electricity Distribution Co. Ltd.* v. *Datar Switchgear Ltd.* [2010] 159 Comp Cas 545 (SC), relieving the chairman of a company against the accusation of fabricating false evidence and false statement in declaration receivable as evidence, the Supreme Court held that in order to attract section 34 of the Indian Penal Code, 1860, the complaint must, prima facie, reflect a common prior concert or planning amongst all the accused. In the present case, the complaint did not indicate the existence of any prearranged plan whereby the chairman had, in collusion, with the other accused decided to fabricate the document in question and adduce it in evidence before the arbitral tribunal. Section 34 of the Indian Penal Code, 1860, was not attracted in his case.

A similar case came up before the Supreme Court, *Pepsico India Holdings P. Ltd.* v. *Food Inspector* [2011] 161 Comp Cas 197 (SC) and once again the Supreme Court highlighted the requirement that in a complaint against a company and its directors, the complainant has to indicate in the complaint itself as to whether the directors concerned were either in charge of or responsible to the company for its day-to-day management, or whether they were responsible to the company for the conduct of its business. A mere bald statement that a person was a director of the company against which certain allegations had been made is not sufficient to make such director liable in the absence of any specific allegations regarding his role in the management of the company.

The most significant aspect of the ruling is the emphasis laid on sections 5 and 291 of the Companies Act. Section 5 identifies the persons who are to be treated as officers who in default for the purpose of offences under the Act and they are the persons who are closely connected with the management of affairs of a company (especially the managing director and whole-time director). The settled position is that a managing director is prima facie in-charge of and responsible for the company's business and affairs and can be prosecuted for offences by the company. But so far as other directors are concerned, they can be prosecuted only if they were in-charge of and responsible for the conduct of the business of the company.

Finally, the Supreme Court has cautioned that if the accused is not one of the persons who falls under the category of "persons who are responsible to the company for the conduct of the business of the company" then merely by stating that "he was in-charge of the business of the company" or that "he was in-charge of the day-to-day management of the company" or that "he was in charge of, and was responsible to the company for the conduct of the business of the company", he cannot be made vicariously liable under section 141(1) of the Act. To put it clear that for making a person liable under section 141(2), the mechanical repetition of the requirements under section 141(1) will be of no assistance, but there should be necessary averments in the complaint as to how and in what manner the accused was guilty of consent and connivance or negligence and therefore, responsible under sub-section (2) of section 141 of the Act.

This decision should check the general tendency to arraign all directors including those who were not directors on the date of signing the cheque and non-executive directors who are not concerned with nor do they have powers of management of day-to-day affairs of the company.

In another case (*Central Bank of India* v. *Asian Global Ltd.* 163 Comp Cas 398 (SC) again the Supreme Court said (page 403) :

> "In this case, save and except for the statement that the respondents, Mr. Rajiv Jain and Sarla Jain and some of the other accused, were directors of the accused companies and were responsible and liable for the acts of the said companies, no specific allegation has been made against any of them. The question of proving a fact which had not been mentioned in the complaint did not, therefore, arise in the facts of this case. This has prompted the High Court to observe that the bank had relied on the mistaken presumption that as directors, Rajiv Jain, Sarla Jain and the other directors were vicariously liable for the acts of the company. Admittedly, except for the aforesaid statement, no other material has been disclosed in the plaint to make out a case against the respondents that they had been in charge of the affairs of the company and were responsible for its action. The High

> Court, therefore, rightly held that in the absence of any specific charge against the respondents, the complaint was liable to be quashed and the respondents were liable to be discharged."

There cannot be any vicarious liability in the absence of any allegations and material to show that the appellant was in charge of and responsible for the conduct of the company's business which has given rise to the offence[1].

In *A. R. Radha Krishna* v. *Dasari Deepthi* [2019] 213 Comp Cas 352 (SC), the Supreme Court held : The law requires that the complaint must contain a specific averment that the director was in charge of, and responsible for, the conduct of the company's business at the time when the offence was committed. The High Court, in deciding a petition under section 482 of the Code of Criminal Code, 1973, must consider whether the averment made in the complaint is sufficient or if some unimpeachable evidence has been brought on record which leads to the conclusion that the director could never have been in charge of and responsible for the conduct of the business of the company at the relevant time. While the role of a director in a company is ultimately a question of fact, and no fixed formula can be fixed therefor, the High Court must exercise its power under section 482 of the Code when it is convinced, from the material on record, that allowing the proceedings to continue would be an abuse of process of the court.

Whether money not accepted as deposit is deposit

Dr. Lohith Shivateja v. *Anytime Medicare Services P. Ltd.* [2019] 213 Comp Cas 57 (NCLT)

In this case, the National Company Law Tribunal refused to entertain a petition filed by a person who had given some money to the respondent-company which the claimed to be by way of business investment as a business partner specifically for the establishment of long-term project by way of partnership arrangement with the company, but the petitioner claimed that it was given by way of a deposit and hence filed a petition for an order to refund it under section 73(4) of the Companies Act, 2013.

Section 73(3) of the Act provides that "Every deposit accepted by a company under sub-section (2) shall be repaid with interest in accordance with the terms and conditions of the agreement referred to in that sub-section". Sub-section (4) gives the Tribunal the power to order refund of a deposit. It provides that "Where a company fails to repay the deposit or part thereof or any interest thereon under sub-section (3), the depositor concerned may

1. *M. A. A. Annamali* v. *State of Karnataka* [2010] 8 SCC 524.

apply to the Tribunal for an order directing the company to pay the sum due or for any loss or damage incurred by him as a result of such non-payment and for such other orders as the Tribunal may deem fit".

It is obvious from the facts in order of the National Company Law Tribunal in this case, that there was a dispute as to the true nature of money paid to the company by the petitioner. The National Company Law Tribunal held, dismissing the petition, that the petitioner had not filed any document to show any invitation was issued by the company from the public including the petitioner. The petitioner had not produced any material to show that in response to notification it had deposited the money. Therefore, the claim of the petitioner was not maintainable under section 73(4) of the Act.

The provisions of the Companies Act, 2013 with regard to deposits are so wide in scope that they are not ambiguous but are likely to give rise to this type of dispute more often. In an anxiety to protect the interest of the people who invest their money in companies who invite or accept money by way of deposits under their deposit schemes but fail repay them or interest thereon, the provisions would seem to have been made unnecessarily wide bringing within their ambit many commercial transactions and branding as deposits monies which are not truly deposits. Lack of clarity is the hallmark of the provisions of the Companies Act, 2013 on this subject. The Government indeed needs to make the law simple and exclude all types of commercial transactions without any conditions and let the parties to such transactions get resolve their disputes by resorting to the remedies available under the laws of the land. There is no need to burden the provisions of the Companies Act on "deposits" and thereby the National Company Law Tribunal.

The term deposit is defined in section 2(31) of the Companies Act, 2013 ("the 2013 Act") as : "deposit" includes any receipt of money by way of deposit or loan or in any other form by a company, but does not include such categories of amount as may be prescribed in consultation with Reserve Bank of India.

The Companies (Acceptance of Deposits) Rules, 2014 ("the Rules"), further exclude some categories from the term of deposit in its rule 2(1)(c). Sub-clauses (i) to (xviii) of rule 2(1)(c) lists down the categories of exempted deposits.

The definition of "deposit" is an inclusive definition. This definition corresponds to the definition in the *Explanation* appended to section 58A of the Companies Act, 1956 ("the 1956 Act"), according to which deposit meant any deposit of money with, and included any amount borrowed by, a company. The new definition is wider in form (as it seeks to treat as deposit any receipt of money by way of deposit or loan or in any other form by a company) but it is not much different than the previous definition in substance.

In the context of banking business, "deposit" means money placed in a bank account or an instance of placing money in a bank account ; an amount of money paid into a bank account or held in a bank account, especially when it is earning interest. But in ordinary sense, the word "deposit" has several meanings, such as a payment, especially into a bank account ; a sum of money which you pay when you rent something, and which is returned to you when you return the thing you have rented ; money which is saved in a bank or something similar.

As per section 2(31) of the 2013 Act, receipt of money by way of loan is included in the definition of deposit. The question is whether any receipt of money in the nature of loan is considered as the deposit for the purposes of the 2013 Act ?

The word "includes" is a word of extension to cover things which do not fall within the ordinary meaning of the word defined. It is also a word of limitation, if the context so requires, to give an exhaustive explanation of that defined word.

The word "includes" enlarges the meaning of the words or phrases occurring in the body of the statute and are construed as comprehending not only such things as they signify according to their nature and import but also things which the interpretation clause declares that they should include. When the definition expressly includes things which are not covered within the ordinary meaning of the word, it is clear that the intention of the Legislature was to give a wide meaning to that word itself apart from the definition (*CIT* v. *Taj Mahal Hotel* [1971] 82 ITR 44 (SC)). Words thus defined denote extension and they cannot be treated as restricted in any sense. Inclusive definition is an indication of extension and expansion and not restriction (*Dr. P. Vadamalayan* v. *CIT* [1969] 74 ITR 94 (Mad)). It is specie of fiction. The word in respect of which "includes" is used bears both the extended statutory meaning and its ordinary popular and natural meaning (*Premier Mills Ltd.* v. *CIT* [1985] 152 ITR 457 (Mad)). The word "includes" is susceptible of another construction which may become imperative. If the context of the 2013 Act is sufficient to show that it was not merely employed for the purpose of adding to the natural significance of the words and expressions defined. It may be equivalent to "means and includes" and in that case it may afford an exhaustive explanation of the meaning which, for the purpose of the Act must invariably be attached to these words or expressions[1].

Therefore the question arises whether any money borrowed by a company for its business purposes is "deposit" even if in true sense and having regard to the purpose and context of sections 73 to 76 of the 2013 Act and the Rules it is not a deposit and even if it has not been expressly excluded under rule 2(1)(c) of the Rules, or whether if money borrowed is not in the nature of a deposit but is a loan and even if it has not been expressly excluded under rule 2(1)(c) of the Rules is not a deposit.

It is true that according to the definition given in section 2(31) of the 2013 Act, deposit includes any amount borrowed by a company, and by applying the "literal interpretation rule", any money borrowed by a company amounts to deposit. This is a wider definition and seeks to include any and every amount borrowed even if an amount borrowed may not really be in the nature of deposit as contemplated by the section and also the purpose of such borrowing is not what section 58A has behind its enactment.

However, on reading sections 73 and 76 of the 2013 Act, it would be apparent that the intention of the section is to regulate deposits accepted or invited by a company from the members and from persons other than members. These sections have been enacted to regulate the deposits accepted or invited from its members and any person other than its members.

The distinction between "deposit" and "loan" is well recognized and settled. In a transaction of a deposit of money or a loan, a relationship of a debtor and a creditor must come into existence. The terms "deposit" and "loan" may not be mutually exclusive, but nonetheless in each case what must be considered is the intention of the parties and the circumstances. What must also be borne in mind is that under the Limitation Act, the period when limitation would begin in a case of deposit and in a case of lending are differently provided. Hence, the distinction between a loan and a deposit is fine but appreciable (*Durga Prasad Mandelia* v. *Registrar of Companies, Maharashtra* [1987] 61 Comp Cas 479 (Bom)).

The Bombay High Court has held that both in the case of a loan and in the case of a deposit, there is a relationship of a debtor and a creditor between the party giving money and the party receiving money. But in the case of a deposit, the delivery of money is usually at the instance of the giver, and it is for the benefit of the person who deposits the money the

1. *Dilworth* v. *Commissioner of Stamps* [1899] AC 99, *Mahalakshmi Oil Mills* v. *State of A. P.* [1989] 1 CLA 156 (SC), *Premier Mills Ltd.* v. *CIT* [1985] 152 ITR 457 (Mad).

benefit normally being earning of interest from a party who customarily accepts deposits. Deposits could also be for safe keeping as a security for the performance of an obligation undertaken by the depositor. In the case of a loan, however, it is the borrower at whose instance and for whose needs the money is advanced. The borrowing is primarily for the benefit of the borrower although the person who lends the money may also stand to gain thereby by earning interest on the amount lent. Ordinarily, though not always, in the case of a deposit, it is the depositor who is the prime mover while in the case of a loan, it is the borrower who is the prime mover (*Pennwalt India Ltd.* v. *Registrar of Companies, Maharashtra* [1987] 62 Comp Cas 112 (Bom)).

The Supreme Court has observed that the case of a deposit is something more than a mere loan of money. It will depend upon the facts of each case whether the transaction is clothed with the character of a deposit of money. The surrounding circumstances, the relationship and character of the transaction and the manner in which parties treated the transaction will throw light on the true form of the transaction[1].

The Supreme Court held that a loan "imports a positive act of lending coupled with an acceptance by the other side of the money as loan" (*Shree Ram Mills Ltd.* v. *CEPT* [1953] 23 ITR 120 (SC)). In another decision, the Supreme Court has held that whether a transaction is a transaction of loan or deposit does not depend merely on the terms of the document but has got to be judged from the intention of the parties and all the circumstances of the case. Even though the transaction is a transaction of deposit, the deposit can be coupled with an agreement that it will be payable on demand. Such an agreement can be express or implied and if an express agreement in that behalf is recorded in the document the transaction of deposit cannot thereby be converted into a transaction of loan[2].

The definition of deposit under section 2(31) of the 2013 Act has three ingredients : (1) any receipt of money by way of deposit ; (2) any receipt of money by way of loan ; and (3) any receipt of money in any other form.

This definition had two ingredients : (1) any deposit of money ; and (2) any amount borrowed. It will be noticed that except the third ingredient mentioned above, the two definitions are virtually the same in substance. The second ingredient in both the definitions, namely, "any receipt of money by way of loan" and "any amount borrowed" is virtually the same in substance. In fact, one of the meanings of "loan" in a standard dictionary is a thing that is borrowed, especially a sum of money that is expected

1. *Ram Janki Devi* v. *Juggilal Kamlapat,* AIR 1971 SC 2551 ; [1971] 1 SCC 477.
2. *V. E. A. Annamalai Chettiar* v. *S. V. V. S. Veerappa Chettiar,* AIR 1956 SC 12.

to be paid back with interest (see *Concise Oxford English Dictionary*). The *Oxford Business English Dictionary* defines it as "money that an organisation such as a bank lends and somebody borrows". Thus, although the new definition is an inclusive definition and it looks wider in form than the old definition (as it seeks to treat as deposit any receipt of money by way of deposit or loan or in any other form by a company), in my opinion, it is not much different than the previous definition in substance. The third ingredient in the definition given in the 2013 Act, namely, "any receipt of money in any other form" although sounds extremely wide if read in isolation, must in my view be read by applying the rule of ejusdem generis.

Sections 58A and 58B were inserted by the Companies (Amendment) Act, 1974. The purpose was stated in the Notes on Clauses thus :

> "*Clause 6*—It has been the practice of the companies to take deposits from the public at a high rate of interest. Experience has shown that in many cases deposits so taken by the companies have not been refunded on the due dates. In many such cases either the companies have gone into liquidation or the funds are depleted to such an extent that the companies are not in a position to refund the deposits. It is accordingly considered necessary to control the companies inviting deposits from the public. The issue of an advertisement in such form and in such manner as may be prescribed including therein a statement showing the financial position of the company seeking deposits from the public is being made obligatory. Provision has also been made for the Central Government to make rules in consultation with the Reserve Bank of India. Penal provisions have also been included. There is also a provision for the refund of the amount of deposits received by a company in violation of the requirements of the law. The provisions of the Act relating to a prospectus are also made applicable to the issue of such advertisements as contemplated in this clause. The clause will be applicable to all companies other than the banking companies and those specified by the Government in consultation with the Reserve Bank of India."

It is true that the Statement of Objects and Reasons or Notes on Clauses appended to a Bill presented in Parliament as such may not be admissible as an aid of construction to the statute but, as the Supreme Court has pointed out, it can be referred to for the limited purpose of ascertaining the conditions prevailing at the time which actuated the sponsor of the bill to introduce the same and the extent and urgency of the evil which it sought to remedy[1]. As the Statement of Objects and Reasons stated, the purpose of section 58A was "to control the companies inviting deposits from the public" and not to ban borrowing of monies by companies for business purposes under a genuine and legitimate agreements between the company and the lender when the lender is clear in his intention that he is giving his money to the company as a loan and not as a deposit and the intention of the parties is clearly stated in the agreement. As the Supreme Court pointed out in *Delhi Cloth and General Mills Co. Ltd.* v. *Union of India* [1983] 54 Comp Cas 674 (SC) referred to below, section 58A had a definite object, namely, "to check the abuse by the corporate sector and to protect the depositors/investors".

Secondly, as noted earlier, the purpose behind the provisions in section 73 is the same as was behind section 58A of the 1956 Act, namely to protect the interests of the persons who keep their money with companies by way of deposit. The purpose of and reasons for enacting section 58A of the 1956 Act was explained by the Supreme Court in *Delhi Cloth and General Mills Co. Ltd.* v. *Union of India* [1983] 54 Comp Cas 674 (SC) affirming the decision of the Gujarat High Court in *Ahmedabad Manufacturing and Calico Printing Co. Ltd.* v. *Union of India* [1983] 53 Comp Cas 904 (Guj), thus (page 695 of 54 Comp Cas) :

> ". . . it was designed to meet cases of abuse or distortion of system, which have, of late, assumed comparatively serious proportions, and a stringent measure of control has become inevitable . . . The power conferred by section 58A on the Central Government to prescribe the limits up to which the manner in which and the conditions subject to which deposits may be invited or accepted by non-banking companies had a definite object, namely, to check the abuse by the corporate sector and to protect the depositors/investors. Mischief was known and the regulatory measure was introduced to remedy the mischief. The conditions which can be prescribed to effectuate this purpose must a fortiori, to be valid, fairly and reasonably, relate to check-mate the abuse of juggling with the depositors'/investors' hard earned money by the corporate sector and to confer upon them a measure of protection, namely, availability of liquid assets to meet the obligation of repayment of deposit which is implicit in acceptance of deposit . . . Section 58A must receive its legitimate construction in the backdrop of this fact-situation. Viewed from this angle, section 58A will enable the Central Government to prescribe conditions subject to

1. *M. K. Ranganathan* v. *Government of Madras*, AIR 1955 SC 604 and *Prabhudas Damodar Kotecha* v. *Manhabala Jeram Damodar*, AIR 2013 SC 2959.

which deposits can be accepted and one such condition would be how to readily make, a small portion of the deposit, available for repayment because while inviting and accepting deposits, it is implicit therein that repayment would be assured on the date of maturity."

The purpose of the provisions in Chapter V of the 2013 Act is the same as was in the case of section 58A of the 1956 Act, i. e., to regulate deposits invited by the companies from the public or their shareholders and thereby protect or safeguard the interests of the depositors (most of whom are those who invest their monies in deposits of companies in small amounts) and it is not the purpose of these provisions to bring genuine loan transactions by which a company borrows money for the purpose of its business and when the lender has the clear and avowed intention of lending money and not giving money by way of a deposit. Unless money received by the company is not by way of deposit and the payer of the money and the recipient of the money, i. e., the company have a clear intention and understanding that the money is not being given as a deposit with a view to earning interest on it, in my opinion, it would not amount to deposit and hence the provisions of the 2013 Act and the Rules relating to deposits would not apply.

In this regard, two decisions of the Company Law Board on interpretation of the word deposit for the purposes of section 58A of the 1956 Act are noteworthy.

The Company Law Board held, while interpreting section 58A, that "This section is limited to invitation and acceptance of deposits from the public or from the members of the company. The money received from the public or the members must be in the nature of 'deposit'. In order to attract this section it is required to be seen whether a deposit is invited or accepted by the company from the public or from its members in accordance with the Companies (Acceptance of Deposits) Rules, 1975. These Rules bring out certain special features of deposit distinguishing it from a loan". In this connection, beneficial reference is invited to *V. E. A. Annamalai Chettiar* v. *S. V. V. S. Veerappa Chettiar*, AIR 1956 SC 12, wherein the apex court has made a clear distinction between loan and deposit although, in a particular case, loan may include deposit. But then, every loan is not a deposit. Whether a transaction is a loan or deposit has to be judged from the intention of the parties and the circumstances of the case. By virtue of rule 3(1)(a) of the Companies (Acceptance of Deposits) Rules, 1975, no company shall accept any deposit which is repayable on demand or on notice or after a period of less than six months or more than thirty-six months from the date of acceptance of such deposit. Every company intending to invite deposits from the public shall issue an advertisement in accordance with rule 4 or file a statement in lieu of advertisement as the case may be under rule 4A. Every company should furnish to the depositor a receipt for the amount received by the company in the manner prescribed under rule 6. None of these requirements is satisfied by the company, while accepting monies from the depositor. Moreover, copies of the receipts dated February 13, 1991 and April 8, 1991 (document Nos. 1 and 2), produced by the depositor are not in accordance with rule 6. The confirmation of account from the books of the company as at March 31, 1991 (document No. 3), and statements of account for the periods from April 1, 1991 to March 31, 1992 and April 1, 1992 to March 31, 1993 (document Nos. 4 and 5), all issued by the company show that monies advanced to the company are in the nature of loans, repayable on demand as borne out by the receipts dated February 13, 1991 and April 8, 1991 (document Nos. 1 and 2), which is in violation of rule 3(1)(a) stated supra. Considering these circumstances, the character of the transactions, the manner in which the parties treated the transactions as laid down by the Supreme Court in the decision cited by the authorised representative of the depositor and non-fulfilment of the requisite statutory requirements, I am convinced that the monies advanced in the present case cannot amount to "deposit" for the purpose of section 58A (*Girija Smelters Ltd.* v. *Saraswathi Finance Corporation* [2004] 119 Comp Cas 592 (CLB)). It was also held by Company Law Board that "This section is limited to invitation and acceptance of deposits from the public or from the members of the company. The money received from the public or the members must be in the nature of 'deposit'. . . . In order to attract section 58A, it is required to be seen whether the deposits are invited or accepted by the company from the public or from its members in accordance with the Companies (Acceptance of Deposits) Rules, 1975." (*Gopal K. Maheswari* v. *Hawk Multimedia P. Ltd.* [2005] 126 Comp Cas 76 (CLB))

When a person invests in or lends money to a company or pays money in relation to a commercial transaction with a clear understanding on both sides the money is not a deposit as contemplated by section 2(31) read with sections 73 and 76 of the Act and the Rules, but is a loan and such loan is governed only by the terms and conditions specified in the loan agreement between the parties, especially secured by a charge on the company's immovable or movable property or assets or by a guarantee to be repaid during the period and in the manner specified and the agreement clearly envisages the money lent as a loan and not a deposit, it cannot be treated as a deposit for the purposes of the Act.

Rectification of name of a company

NGK Spark Plug Co. Ltd. v. *Union of India* [2019] 213 Comp Cas 138 (Delhi)

Section 16(1)(b) of the Companies Act, 2013 provides that if, through inadvertence or otherwise, a company on its first registration or on its registration by a new name, is registered by a name which, on an application by a registered proprietor of a trade mark that the name is identical with or too nearly resembles to a registered trade mark of such proprietor under the Trade Marks Act, 1999, made to the Central Government within three years of incorporation or registration or change of name of the company, whether under this Act or any previous company law, in the opinion of the Central Government, is identical with or too nearly resembles to an existing trade mark, it may direct the company to change its name and the company shall change its name or new name, as the case may be, within a period of six months from the issue of such direction, after adopting an ordinary resolution for the purpose.

This provision provides a safeguard namely, rectification of name where a company is registered, through inadvertence or otherwise, by a name which is identical with or too nearly resembles, the name by which a company in existence has been previously registered.

The provision is identical to section 22 of the Companies Act 1956, except that the five years limitation was three years in section 22 of the Companies Act, 1956.

In the case in hand the Delhi High Court has held that the object of precluding a registered proprietor from making an application after the expiry of five years is to disentitle the registered proprietor to make such an application on the principle of acquiescence. The limitation of five years from the date of incorporation of a company, which is also the date when notice of such incorporation is available in the public domain.

Waiver of eligibility criteria stipulated for filing a petition under section 241

S. Ahamed Meeran v. *Ronny George* [2019] 213 Comp Cas 166 (NCLAT)

In the Case Law Analysis published in Volume 212, a detailed discussion on this subject has been done, under *Cyrus Investments P. Ltd.* v. *Tata Sons Ltd.* [2019] 212 Comp Cas 269 (NCLAT).

In the case in hand, the National Company Law Appellate Tribunal reversed the decision of the National Company Law Tribunal which had granted a waiver, and held that :

> ". . . the majority of the shareholders had more than 10 per cent. of shareholding except two who held less than 10 per cent. shareholding. Therefore, it could not be held that the first respondent had made out a case of exceptional circumstances for grant of waiver to maintain an application under sections 241 and 242 on such ground. No exceptional circumstance had been shown by the Tribunal to grant waiver. The order was based on wrong presumptions of fact and law and as the first respondent had failed to make out a case for waiver, the order was to be set aside. The petition under sections 241 and 242 preferred by the first respondent before the Tribunal was not maintainable and to be dismissed."

A scheme of compromise or arrangement involving an illegality may not be sanctioned

Avenir Finvest and Leasing P. Ltd., In re [2019] 213 Comp Cas 174 (NCLT)

There are several decisions of the High Courts and the Supreme Court that dwelt upon wide spectrum of powers of the court in sanctioning a scheme of compromise or arrangement under section 391 read with section 394 of the Companies Act, 1956.

The provisions of sections 230, 231 and 232 of the Companies Act 2013 confer on the National Company Law Tribunal almost similar to powers.

It is a settled law that before a court sanctions a scheme of amalgamation under sections 391 and 394 of the Act, it should be satisfied of the following matters :

(1) The resolutions are passed by the statutory majority in value and in number in accordance with sub-section (2) of section 391 at a meeting or meetings duly convened and held. This factor is jurisdictional in the matter of confirmation of the scheme. The court should not usurp the right of the members or creditors to decide whether they approve the scheme or not. Therefore, if a class whose interests are affected by a scheme does not assent to the scheme or approve it at a meeting convened in accordance with the provisions of section 391, the court will have no jurisdiction to confirm the scheme, even if it considers that the class concerned is being fairly dealt with.

(2) Those who took part in the meeting are fairly representative of the class.

(3) The scheme, as a whole, having regard to its objects, background, etc., is a reasonable one. If the court finds it so, it is not for the court to interfere with the collective wisdom of the shareholders of the company. It

will then be for the objector to convince the court that the scheme is unfair and that, therefore, it should exercise its discretion to reject the scheme, despite the favourable views of a very large majority of the shareholders.

(4) The court will not launch an investigation into the commercial merits or demerits of the scheme which is the function of those who are interested in the arrangement.

(5) There should be no coercion of the minority at the statutory meeting. There should not also be any lack of good faith on the part of the majority (*Coimbatore Cotton Mills Ltd., In re* [1980] 50 Comp Cas 623 (Mad)).

(6) The position has been succinctly stated by Lindley L. J.[1] thus :

> "What the court has to do is to see, first of all, that the provisions of that statute have been complied with ; and, secondly, that the majority has been acting bona fide. The court also has to see that the minority is not being overridden by a majority having interests of its own clashing with those of the minority whom they seek to coerce. Further than that, the court has to look at the scheme and see whether it is one as to which persons acting honestly, and viewing the scheme laid before them in the interests of those whom they represent, take a view which can be reasonably taken by businessmen."

(7) The court must not act as a rubber stamp to sanction a scheme approved by the majority. It has a duty to scrutinise, but the scrutiny is not with the eye of an expert or exactness of an accountant. Even if the scheme is open to some criticism that is not enough. Obvious unfairness of the scheme must be affirmatively shown. Indeed, it is settled law that the collective judgment of the vast majority of persons finally affected by the scheme has to be given the greatest possible value (*Hindustan Lever Employees' Union* v. *Hindustan Lever Ltd.* [1995] 83 Comp Cas 1 (Bom)).

(8) The court has to see to it that the requisite statutory procedure for supporting such a scheme has been complied with and that the requisite meetings as contemplated by section 391(1)(a) have been held.

(9) The scheme is backed by the requisite majority vote as required by section 391(2).

(10) The concerned meetings of the creditors or members or any class of them had the relevant material to enable the voters to arrive at an informed decision for approving the scheme in question. The decision of the concerned class of voters is just and fair to the class as a whole so as to legitimately bind even the dissenting members of that class.

1. *Alabama, New Orleans, Texas and Pacific Junction Railway, In re* [1981] 1 Ch D 213 at 238, 239 (CA).

(11) All necessary material indicated by section 393(1)(a) is placed before the voters at the concerned meetings as contemplated by section 391(1).

(12) All requisite material contemplated by the proviso to section 394(2) of the Act is placed before the court by the concerned applicant seeking sanction for such a scheme and the court gets satisfied about the same.

(13) The proposed scheme is not found to be violative of any provision of law and is not contrary to public policy. For ascertaining the real purpose underlying the scheme with a view to be satisfied on this aspect, the court, if necessary, can pierce the veil of apparent corporate purpose underlying the scheme and can judiciously X-ray the same.

(14) The court has also to satisfy itself that members or class of members or creditors or class of creditors, as the case may be, were acting bona fide and in good faith and were not coercing the minority in order to promote any interest adverse to that of the latter comprising the same class whom they purported to represent.

(15) The scheme as a whole is also found to be just, fair and reasonable from the point of view of prudent men of business taking a commercial decision beneficial to the class represented by them for whom the scheme is meant.

(16) Once the above parameters are met, the court will have no further jurisdiction to sit in appeal over the commercial wisdom of the majority of the class of persons who with their open eyes have given their approval to the scheme even if in the view of the court there would be a better scheme for the company and its members or creditors for whom the scheme is framed. The court cannot refuse to sanction such a scheme on that ground as it would otherwise amount to the court exercising appellate jurisdiction over the scheme rather than its supervisory jurisdiction (*Miheer H. Mafatlal* v. *Mafatlal Industries Ltd.* [1996] 87 Comp Cas 792 (SC)).

(17) By and large, while considering as to whether necessary approval has to be given for holding of the meetings of the shareholders, creditors (secured or unsecured) or subsequently permission is to be granted for amalgamation of the company or scheme of arrangement, the jurisdiction of this court primarily is supervisory. The court is not a rubber stamp. Under the supervisory jurisdiction with a limited scope, the court can see the actual transfer proposed to be effected. The well known doctrine of lifting of veil can be applied. The court can also see whether the scheme is fair and not set up with an object to defeat any provisions of law. That being

the position, one can revert back to the contents of the proposed scheme (*Rama Petrochemicals Ltd., In re* [2000] 100 Comp Cas 807 (P&H)).

(18) According to the ratio of *Hindustan Lever Employees' Union* v. *Hindustan Lever Ltd.* [1995] 83 Comp Cas 30 (SC) and *Miheer H. Mafatlal* v. *Mafatlal Industries Ltd.* [1996] 87 Comp Cas 792 (SC), it is clear that the court, while sanctioning a scheme has not to exercise jurisdiction of an appellate court. It has to exercise jurisdiction founded on fairness and it should not interfere with the wishes of the requisite number of shareholders only because the valuation figure arrived at by the valuer could have been different had some different method been used for the valuation. What is to be seen by the court is that the valuation was as per law or settled principles and was done by an independent body. The company court has not to minutely scrutinize the scheme like an appellate court for arriving at an independent conclusion. The court should interfere only if it finds that the scheme even if sanctioned by the majority, is unconscionable, unfair or illegal. The court should not sit in appeal over the decision of the shareholders or should not impose its wisdom on the shareholders in the matter of their discretion with regard to acceptance of the scheme of amalgamation or otherwise. The court never sits in appeal to decide whether the decision of a requisite majority was right or wrong (*Kiritbhai Hiralal Patel* v. *Arvind Intex Ltd.* [2001] 107 Comp Cas 232 (Guj)).

(19) Once scheme is held to be reasonable and proper, merely because there is one objector to approval of scheme, who is more than sole dissenter, court should not refuse to sanction scheme and what court could do in such circumstances is to give protection to dissenter, by amending scheme[1].

Karnik J. of the Bombay High Court expound this aspect as follows :

> "The company court does not have the jurisdiction to sit in appeal over the commercial wisdom of the majority of the persons who with their open eyes have given their approval to the scheme. Even if in the court's view, some better scheme for the company and its members or creditors could have been framed, the court cannot refuse to sanction the scheme approved by the members on that ground as it would otherwise amount to exercising appellate jurisdiction over the scheme rather than supervisory jurisdiction. In view of the settled position of law, the court cannot look into whether the transferor company could have independently carried its business rather than getting merged with the transferee company. It was for the shareholders of the

1. *DCM Estate and Infrastructure Ltd., In re* [2003] 48 SCL 689 (Delhi).

transferor and transferee companies to consider this aspect. The shareholders in their wisdom have considered and approved the scheme by an overwhelming majority." (*IndusInd Enterprises and Financial Limited, In re* [2004] 120 Comp Cas 457, 464 (Bom))

The wide scope of powers of the court of course has to be exercised subject to certain precautionary limitations as pointed out by the Supreme Court in *Miheer H. Mafatlal* v. *Mafatlal Industries Ltd.* [1996] 87 Comp Cas 792, 812 (SC) in the following words :

"On a conjoint reading of the relevant provisions of sections 391 and 393 it becomes at once clear that the company court which is called upon to sanction such a scheme has not merely to go by the [1]*ipse dixit* of the majority of the shareholders or creditors or their respective classes who might have voted in favour of the scheme by requisite majority but the court has to consider the pros and cons of the scheme with a view to finding out whether the scheme is fair, just and reasonable and is not contrary to any provisions of law and it does not violate any public policy. This is implicit in the very concept of compromise or arrangement which is required to receive the imprimatur of a court of law. No court of law would ever countenance any scheme of compromise or arrangement arrived at between the parties and which might be supported by the requisite majority if the court finds that it is an unconscionable or an illegal scheme or is otherwise unfair or unjust to the class of shareholders or creditors for whom it is meant. Consequently, it cannot be said that a company court before whom an application is moved for sanctioning such a scheme which might have got the requisite majority support of the creditors or members or any class of them for whom the scheme is mooted by the concerned company, has to act merely as a rubber stamp and must almost automatically put its seal of approval on such a scheme. It is trite to say that once the scheme gets sanctioned by the court it would bind even the dissenting minority shareholders or creditors. Therefore, the fairness of the scheme qua them also has to be kept in view by the company court while putting its seal of approval on the concerned scheme placed for its sanction. It is, of course, true that so far as the company court is concerned as per the statutory provisions of sections 391 and 393 of the Act the question of voidability of the scheme will have to be judged subject to the rider that a scheme sanctioned by majority will remain binding on a dissenting minority of creditors or members, as the case may be, even though they have not

1. Ipse dixit—Something asserted but not proved.

consented to such a scheme and to that extent absence of their consent will have no effect on the scheme. It can be postulated that even in the case of such a scheme of compromise and arrangement put up for sanction of a company court it will have to be seen whether the proposed scheme is lawful and just and fair to the whole class of creditors or members including the dissenting minority to whom it is offered for approval and which has been approved by such class of persons with requisite majority vote."

In *Bihari Mills Ltd., In re* [1985] 58 Comp Cas 6 (Guj), the Gujarat High Court explained "the periphery jurisdiction of the company court" and held (page 14) :

"What is the periphery jurisdiction of the company court in the matter of according sanction under section 394(2) of the Companies Act, 1956, has been examined by this court as well as other courts, particularly in the context where a scheme of amalgamation has been adopted either unanimously or on the substantial unanimity of the interests concerned. In exercise of its discretion under section 394 of the Companies Act, the company court has, besides its satisfaction to be arrived at on the report of the chairman of the meetings as to the compliance of the prescribed formalities in the section, particularly about the scheme being approved by the requisite statutory majority of the members present and voting, and also on investigation as to whether there was fair representation of the different interests in their respective meetings directed to be convened, has to be further satisfied whether the majority of these interests was acting bona fide and the proposed scheme is such as a man of business would reasonably approve : vide *Bank of Baroda Ltd.* v. *Mahindra Ugine Steel Co. Ltd.* [1976] 46 Comp Cas 227 (Guj) . . .

In *Wood Polymer Ltd., In re* [1977] 47 Comp Cas 597 (Guj), the Gujarat High Court, in the background of the peculiar fact situation where through the instrumentality of the transferor company, a valuable asset was sought to be acquired by the transferee company with a view to defeat the tax liability arising as a sequel to ordinary transfer of such immovable properties, examined what is the concept of public interest in the second provision to section 394(1), and held that the said expression takes its colour and content in the peculiar statutory context, and in order to determine in a given case whether the proposed scheme is in the public interest or not, the court may embark on an inquiry as to why the transferor company had come into existence, for what purpose it was set up, who were its promoters, who were controlling it and what was the precise object which was sought to be achieved through promotion of the transferor company, and why was it being dissolved by merging it with the transferee company. The court thus examined in *Wood Polymer Ltd., In re* [1977] 47 Comp Cas 597 (Guj), the different factual aspects and having regard to the totality of the circumstances including the report of the official liquidator that the transferor company appeared to have been created solely to facilitate the transfer of the building to the transferee company without attracting the liability to pay capital gains tax, refused to accord sanction to the scheme. The approach of the court, therefore, is not conditional as it is in the proceedings where the courts or the Tribunals proceed on a advisory basis, but it has inquisitorial and supervisory role to play requiring it to form an independent and informed judgment as indicated by the same High Court in *Bank of Baroda Ltd.* v. *Mahindra Ugine Steel Co. Ltd.* [1976] 46 Comp Cas 227 (Guj)."

In the case in hand, the National Company Law Tribunal refused to sanction a scheme of amalgamation on the ground that the transferee company was carrying on activities of a non-banking financial company illegally without the permission of the Reserve Bank of India. Prior approval of the Reserve Bank of India was a must for proceeding further with the consideration of the scheme, which had not been obtained. Hence the court would not sanction the scheme.

The order of the National Company Law Tribunal was affirmed by the National Company Law Appellate Tribunal reported at *Avenir Finvest and Leasing P. Ltd.* v. *Regional Director (Northern Region)* [2019] 213 Comp Cas 180 (NCLAT), with the following observation (page 183) :

"... it was clear that the transferee company was carrying on activities of a non-banking financial company which, according to the Reserve Bank of India, was illegal, as no permission of the Reserve Bank of India had been taken. In view of the specific plea taken by the Reserve Bank of India and brought to the notice of the Tribunal by both the Registrar of Companies and the Regional Director, no interference was called for with the order dated August 11, 2017."

In *Bank Street Securities P. Ltd., In re* [2019] 213 Comp Cas 184 (NCLT), the National Company Law Tribunal held that since all the companies involved in the scheme were carrying non-banking financial activity and therefore required approval of the Reserve Bank of India and since the approval was not in place, the petition was to be dismissed.

What is the time limit for filing a petition under section 241 ?

Kuldeep Singh v. *Sainis Cold Retreaders P. Ltd.* [2019] 213 Comp Cas 306 (NCLT)

In the case Chandigarh Bench of the National Company Law Tribunal has held that the petitioner did not specify when he acquired the knowledge of the allotment of additional shares or increase in the capital. In the absence thereof, it could be safely deduced that the petitioner was well aware of the increase in the share capital decided by respondent No. 1-company soon after it was resolved in the year 2009 itself. The petition was time barred.

The Bench pointed out that (page 311) :

> "The hon'ble Principal Bench of the National Company Law Tribunal, New Delhi, in the case of C. P. No. 108/ND/2016 *Esquire Electronics* v. *Netherlands India Communications Enterprises Ltd.* decided on October 6, 2016 held that for the petitions based on such allegations, article 113 of the Schedule to the Limitation Act would apply and the period would be three years from the date when right to sue accrues. It was further held that section 5 of the Limitation Act with regard to condonation of delay would not apply to the proceedings before the Tribunal as it is the original court of jurisdiction and the petitions before it under sections 241 and 242 of the Act are in the nature of suits. The adjudication by the Tribunal would result into passing of a decree which is executable by virtue of sections 424 and 425 of the Act.
>
> The judgment of *Esquire Electronics* v. *Netherlands India Communications Enterprises Ltd.*, was taken in appeal before the hon'ble National Company Law Appellate Tribunal, being Company Appeal (AT) No. 26 of 2016—*Esquire Electronics Inc.* v. *Netherlands India Communications Enterprises* [2017] 205 Comp Cas 552 (NCLAT). The hon'ble Appellate Tribunal affirmed the view that the provisions of the Limitation Act, apply to the proceedings or appeal before the Tribunal or Appellate Tribunal, as the case may be. It was also observed that the Tribunal rightly held that the decisions in the petition under sections 397 and 398 of the Act, are enforceable like decree and for all purposes, is suit within the meaning of Code of Civil Procedure. It was also affirmed that article 113 of the Limitation Act, providing a period of three years would be attracted."

Law under the Companies Act, 1956

Like under the 1956 Act, there is no provision in the 2013 Act regarding a limitation in terms of period for filing a petition.

(a) Limitation Act

Is there any time limit for filing a petition ? Can a member petition in respect of oppressive acts that took place a long ago and, if so, how much ? Can a member ventilate his grievances through a petition under section 241 a decade ago ? These questions often bother the petitioners potential petitioners and confront the Company Law Board, for there is no time limit prescribed in the Companies Act or the Company Law Board Regulations. Two other that keep confronting are : Do the provisions of the law of limitation apply ? Does the general principle of "laches" apply ?

Section 433 provides that, the provisions of the Limitation Act, 1963 (36 of 1963) shall, as far as may be, apply to proceedings or appeals before the Tribunal or the Appellate Tribunal, as the case may be.

The issue whether the provisions of the Limitation Act, 1963 are applicable to the petition filed under section 397/398 or not has come up before the Company Law Board time and again, and it has been held in several decisions that the Limitation Act does not apply. This is based on the view that the provisions of that the Limitation Act are applicable only with respect to proceedings before "courts" and although the Company Law Board has been clothed with some of the powers of courts, it is not a court.

Though the Limitation Act does not expressly so provide, it is, nonetheless, well-settled that the provisions of the Limitation Act are not applicable to any proceedings except those before courts and that quasi-judicial bodies, such as the Company Law Board, are not courts, despite the fact that they discharge certain judicial functions. It is equally well-settled that these quasi-judicial bodies cannot resort to the provisions of the Limitation Act in order to condone delays and that unless there is an express provision in the statute under which such body functions, conferring upon it the power to condone delays, it cannot have inherent power to do so.

Reiterating the above propositions, the Supreme Court stated in the case of *Sakuru* v. *Tanaji*[1] :

> "It is well-settled by the decisions of this court in *Town Municipal Council* v. *Presiding Officer, Labour Court* [1970] 1 SCR 51 ; *Nityananda M. Joshi* v. *Life Insurance Corporation of India* [1970] 1 SCR 396 and *Sushila Devi* v. *Ramanandan Prasad* [1976] 2 SCR 845 that the provisions of the Limitation Act, 1963, apply only to proceedings in 'courts' and not to appeals or applications before bodies other than courts such as quasi-judicial Company Law Boards (Tribunal from a date to be notified) or executive authorities, notwithstanding the fact

1. See [1985] 22 ELT 327 (SC) ; [1985] 3 SCC 590 ; AIR 1985 SC 1279.

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> that such bodies or authorities may be vested with certain specified powers conferred on courts under the Codes of Civil or Criminal Procedure."

Section 5 of the Limitation Act no doubt seeks to confer on the courts wide powers of extension of time and condonation of delay, and provides that any appeal or application, may be admitted, if the court is satisfied that there was a sufficient cause for not preferring the appeal or application within the period prescribed under the Act. However, as noted already, the provisions of the Limitation Act are not applicable to the proceedings before the authorities which are not courts, e.g., the Company Law Board.

In *Carbon Corporation Ltd.* v. *Abhudaya Properties P. Ltd.* [1992] 73 Comp Cas 572 (CLB) dealing with an application under section 22A of the Securities Contracts (Regulation) Act, 1956, the Company Law Board has elaborately dealt with this issue, and held that the provisions of the Limitation Act, 1963 are applicable only to proceedings before a court. The Company Law Board is not a court even though it has certain specified powers of courts in respect of certain matters. The special statute under which the proceedings are being held, (i. e., the Securities Contracts (Regulation) Act), does not contain express provisions empowering the Company Law Board to extend the prescribed period of limitation and condone the delay in filing a reference. In view of the decision of the Supreme Court in *Sakuru* v. *Tanaji*, supra, and the provisions of the present Act relating to proceedings under section 22A, there can be no doubt that the provisions of the Limitation Act are not applicable to the proceedings under section 22A of the present Act which is a special statute, and consequently, the Company Law Board has no power to extend the time limit for filing a reference as prescribed in sub-section (4).

However, in *Tommy Mathew* v. *Duroflex Ltd.* [2004] 122 Comp Cas 741 (CLB) held that, by virtue of the decision of a Division Bench of the Calcutta High Court in the case of *Nupur Mitra* v. *Basubani P. Ltd.*[1] after an analysis of various contentions as regards the limitation and delay, it was categorically held that in proceedings under section 111, the provisions of the Limitation Act would apply. The Company Law Board also held that the decision in *Carbon Corporation Ltd.* v. *Abhudaya Properties P. Ltd.* [1992] 73 Comp Cas 572 (CLB) is longer good law.

It was held by the Company Law Board that the plea of limitation does not arise in the case of proceedings in relation to section 397/398. The Company Law Board exercises equitable jurisdiction in its proceedings

1. [1999] 2 Cal. LJ 264 (Cal) ; [1999] 35 CLA 97 (Cal).

under section 397/398 (*Smt. A. Kalyani* v. *Vale Exports P. Ltd.* [2004] 119 Comp Cas 974 (CLB)).

The Company Law Board has also held that the omnibus clause under article 137 of the Limitation Act, 1963, does not apply to the Company Law Board as it is not a court ; consequently, the petition is maintainable and does not suffer from any infirmity on account of limitation[1].

Article 123 of the Limitation Act gives a period of only 30 days to set aside an ex parte decree or rehear an appeal decreed or heard ex parte. But that article does not apply to a proceeding under section 397 or section 398, because no decree is passed nor is it an appeal decided ex parte (*A. S. Bhatty* v. *K. L. Gambhir* [1979] 49 Comp Cas 312 (Delhi)).

The expression "affairs of the company are being conducted" appearing in both the sections 397 and 398 of the Act shows a kind of continuing wrong and a fresh period of limitation would begin to run at every moment of the time during which the breach or wrong continue as provided under section 22 of the Limitation Act ; and since the existence of the continuous wrong is the sine qua non for the maintainability, no question of limitation can arise. Article 137 of the Limitation Act cannot, therefore, apply to a petition under section 397 or 398[2].

The provisions of the Limitation Act do not apply to the proceedings before the quasi-judicial Tribunals like the Company Law Board. Further the oppression/mismanagement is a continuous cause in the case of family partnership company till filing of the petition under section 397/398 (*Harish Kumar Berry* v. *S. Berry's Automotive Udyog P. Ltd.* [2006] 129 Comp Cas 568 (CLB)).

The provisions of the Limitation Act do not become applicable to the proceedings before the quasi-judicial Tribunals like the Company Law Board. Further the oppression/mismanagement is a continuous cause in the case of family partnership company till filing of the petition under section 397/398 (*Harish Kumar Berry* v. *S. Berry's Automotive Udyog P. Ltd.* [2006] 129 Comp Cas 568 (CLB)).

The provisions of the Limitation Act do not apply to the petition under section 397/398. If the purported irregularities and statutory violation

1. *A. V. Sampat, Official Liquidator* v. *Dunlop India Ltd.* [1995] 19 CLA 69 (CLB) ; [1995] 4 Comp. LJ 254 (CLB) ; [1996] 87 Comp Cas 398 (CLB). Relying on *Dr. Baliram Waman Hiray* v. *Justice B. Lentin*, AIR 1988 SC 2267 ; [1989] 176 ITR 1 (SC) and *Jagannath Prasad* v. *State of Uttar Pradesh*, AIR 1963 SC 416. Distinguishing *Indian Chemical Products Ltd.* v. *State of Orissa*, AIR 1967 SC 253 and *Luxmi Chand* v. *Bengal Coal Co.*, ILR 8 Cal 317 ; *G. N. Byra Reddy* v. *Arathi Cine Enterprises P. Ltd.* [1997] 89 Comp Cas 745 (CLB).
2. *A. Brahmaraj* v. *Sivakumar Spg. Mills P. Ltd.* [1986] 3 Comp. LJ 109 (Mad).

alleged were such that their effect, if established, would amount to continuous acts of oppression and mismanagement in the affairs of the company, the Board held that, such petition could not be hit by the Limitation Act[1].

(b) Laches

Laches (or laches) is old French word for slackness or negligence or not doing. Laches in law is failure to do something at the proper time, esp. such delay as will bar a party from bringing a legal proceeding ; negligence in the observance of duty or opportunity ; undue delay in asserting a legal right or privilege ; laziness or lack of promptitude in pursuing a legal remedy. Laches means neglect and unreasonable delay in enforcing an equitable right. If a plaintiff with full knowledge of the facts takes an unnecessarily long time to bring an action (e.g., to set aside a contract obtained by fraud) the court will not assist him ; hence the maxim "the law will not help those who sleep on their rights".

Though the provisions of the Limitation Act are not applicable to proceedings under sections 397 and 398 before the Company Law Board, yet laches in filing a petition would be relevant ; hence, if there is abnormal delay in bringing a matter before the Company Law Board, the limitation has to be taken into consideration (*A. P. Jain* v. *Faridabad Metal Udyog P. Ltd.* [1999] 95 Comp Cas 76 (CLB). See also *Suresh Kumar Sanghi* v. *Sanghi Bros. (Indore) Ltd.* [2008] 141 Comp Cas 17 (CLB) ; *Mohinder Singh* v. *Hoshiarpur Express Transport Co. Ltd.* [2008] 141 Comp Cas 345 (CLB) and *Rajesh Patil* v. *Moonshine Films P. Ltd.* [2008] 141 Comp Cas 482 (CLB)).

It has been held with regard to section 459 of the English Companies Act, 1985 that the court should not entertain a petition or grant relief under section 461 on the basis of conduct of the company's affairs in which the petitioners had participated without protest nine years before presentation of the petition. The section is not subject to any limitation, but relief under the section is always within the discretion of the court[2].

Issue of shares by preferential offer without a special resolution may amount to oppressive conduct

Rachakonda Siva Kumar v. *Zetatek Engineering Systems P. Ltd.* [2019] 213 Comp Cas 337 (NCLAT)

1. *M. Murali Krishna* v. *RDF Power Projects Ltd.* [2005] 4 Comp. LJ 119 (CLB) ; [2005] 57 SCL 112 (CLB).
2. *Hough* v. *Hardcastle, Re Grandactual Ltd.* [2006] BCC 73 (Ch D).

Section 62(1)(a) of the 2013 Act contains provisions regarding the issue of shares by a company on rights basis while section 62(1)(c) permits issue of shares in a manner other than by rights issue.

According to section 62(1)(c), a company may offer further shares to any persons, if it is authorised by a special resolution, whether or not those persons include the persons referred to in clause (a) or clause (b), either for cash or for a consideration other than cash, if the price of such shares is determined by the valuation report of a registered valuer subject to such conditions as may be prescribed. This means that a company may offer its new shares to any person(s) in any manner other than that stated in section 62(1)(c) (i. e., rights basis), if the conditions laid down in section 62(1)(c) are complied with. In other words further shares, instead of being offered to the existing members on pro rata basis, can be offered—

(a) to persons other than the members of the company ; or

(b) to the existing members of the company and also to persons other than the existing members ; or

(c) to the existing members of the company in proportion other than pro rata, that is, other than in proportion to the capital paid-up on the shares held by them.

To authorise the company to offer shares on a no rights basis, the shareholders of the company must approve the proposal in a general meeting by a special resolution. This resolution may be passed either at an annual general meeting or an extraordinary general meeting or by postal ballot.

As held and emphasised repeatedly in a large number of cases by the Indian and English courts 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 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 the affairs of a company. The acts of the 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.

The power to issue shares in a company is basically vested with the board of directors of the company. The articles of association usually contain provisions empowering the board to issue unissued shares. The articles of association invariably provide that subject to the provisions of the Act and the articles, the shares in the capital of the company for the time being shall be under the control of the directors who may allot or otherwise dispose of the same or any of them to such persons, in such proportion and on such terms and conditions and either at a premium or at par or at a discount and at such times as they may from time to time think fit.

The courts have in several cases dealt with the scope and limitation of the board's power to issue shares. The director's power to issue shares is a fiduciary one, not to be exercised for an improper purpose, and it is generally speaking improper for the directors to use their fiduciary powers over the shares in the company purely for the purpose of destroying an existing majority, or creating a new majority which did not previously exist (*Howard Smith Ltd.* v. *Ampol Petroleum Ltd.* [1974] AC 821 (PC)). The fact that by the issue of shares the directors succeed, also or incidentally, in maintaining their control over the company or in newly acquiring it, does not amount to an abuse of their fiduciary power. What is considered objectionable is the use of such powers merely for an extraneous purpose like maintenance or acquisition of control over the affairs of the company (*Needle Industries (India) Ltd.* v. *Needle Industries Newey (India) Holding Ltd.* [1981] 51 Comp Cas 743 (SC)).

The power of issue of shares is always considered to be fiduciary power of directors to be used not only in the interest of the company as a whole but also without causing unfair prejudice to the minority shareholder. In the arena of section 397 petitions, it has always been a knotty issue as to whether the directors' exercise of the fiduciary power of issue of shares resulting into either the majority getting converted into minority or the minority becoming a weaker minority (even reducing to less than ten per cent.) is justified on the grounds that the company was in need of money and the action had to be taken fast else the company would face severe consequences.

In UK the courts are generally averse to upholding such an action and the simple question that was asked is why the shares could not be offered to all the shareholders pro rata so that in the event of any shareholder not picking up the shares offered, another shareholder acquiring it would not be blameworthy to those who acquired the shares even if the acquisition results into titling the balance into only one or some and all of the shareholders of the company. This would also facilitate to keep intact the principle of fiduciary duty of directors in the matter of issue of shares. The UK courts have gone to the extent of holding that even the rights issue made at a time when the majority shareholder knows that the minority cannot subscribe to the shares is oppressive (unfairly prejudicial). With regard to rights issues, the form of the transaction may be important. For example, if the majority know that the petitioner does not have the funds to take up his rights, but the offer is made at par in circumstances where the shares are worth much more than par as part of a majority holding but very little as part of a minority holding, viewed objectively, the transaction may well be unfairly prejudicial. An important consideration is the motive of the board. The fact that the members of the board genuinely and on reasonable grounds believe that the company requires further funds will not necessarily mean that the rights issue is not unfairly prejudicial to the petitioner's interests. But if the motive is to reduce the petitioner's shareholding, and the members of the board are aware that the petitioner does not have the money to take up his entitlement to shares, the petitioner's interests will have been unfairly prejudiced[1].

In the context of the decision of the Additional Principal Bench, Chennai, of the Company Law Board in *R. Siddharth* v. *Spectrapacks P. Ltd.* [2011] 161 Comp Cas 67 (CLB), after reading the order of the learned member, one is left wondering as to why the learned member did not consider it apt to ask the respondent the question as to why the board of directors representing the majority shareholder did not think it proper to make a rights offer instead of preferential offer to themselves. On the contrary, the learned member justified the preferential issue (which reduced the 49 per cent. respectable minority to awfully poor 6 per cent.) and held that the first respondent-company was in a financial crunch and the bank had declared its account as a non-performing assets. In order to avoid distress sale of the assets of the first respondent-company, the members of the C group took loans on security of their personal properties and invested the amount through the fourth respondent. When the money was brought in at a crucial juncture, it could not be contended that such money should have been brought in only as a loan. The allotment of shares within total authorised share capital of the company at par to the fourth respondent was for justifiable reasons. The prompt action of the C group had salvaged the properties of the first respondent-company, especially when the first petitioner had abandoned the company. It was a decision of the board to allot the non-subscribed shares and the Company Law Board could not suggest what was best for the company. The object of the allotment was need based, honest and for the best interest of the company and not to increase the shareholding of the respondents, though it incidentally reduced the shareholding of the minority and did not call for interference.

1. *Minority Shareholders Law, Practice and Procedure, Oxford University Press,* page 260.

The petitioners had not invested any money in the company, no amount was due to the petitioners towards his salary. The act of the respondents was in the interest of the company and gain to the respondents was without any ulterior motive. The petitioners were not eligible for any equitable consideration.

Curiously, the learned member also observed that considering the long association of the first petitioner with the first respondent-company, the respondents would do good in offering more than a fair value for the petitioners' shares. Thus, the majority would get rid of the minority shareholder and acquire hundred per cent. control over the company. This is not less than putting a premium on the oppressor (see discussion at the case discussed under heading "Oppression of minority shareholder by majority—putting a premium on the oppressor" above). The decision leaves much to be desired.

The National Company Law Tribunal has held in *Rachakonda Siva Kumar* v. *Zetatek Engineering Systems P. Ltd.* [2019] 213 Comp Cas 337 (NCLT), that in case shares were not issued under section 62(1)(a), the law envisaged that special resolution was a must whenever shares were to be issued under section 62(1)(b) or 62(1)(c). No material had been produced to show that the special resolution had been passed nor had any material been placed before the Tribunal to show that the fair price had been determined by a registered valuer. In the absence of fair value, it could not be determined that Rs. 10 was the fair value of the equity share. Though enough had been pleaded to justify allotment of 90,000 shares to the second respondent no evidence had been pleaded or produced to show compliance with section 62(1)(c). Therefore, the allotment of 90,000 shares to the second respondent could not be held to be validly done. The exercise carried out was illegal and oppressive to the appellant.

A company branded as "shell company" and investigation ordered—Violative of principles of natural justice

Assam Co. India Ltd. v. *Union of India* [2019] 213 Comp Cas 420 (Gauhati)

The Government drive of striking off companies which are branded "shell companies, has entered legal battle in a few cases on the ground of violation of principles of natural justice.

In fact, the relevant provisions of the Companies Act, 2013 do embody principles of natural justice.

Section 248 of the Companies Act, 2013 contains provisions regarding striking of companies by the Registrar of Companies from the register, thereby bringing the life of a company to an end. Sub-section (1) of this section provides that, where the Registrar has reasonable cause to believe that—

• a company has failed to commence its business within one year of its incorporation ; or

• a company is not carrying on any business or operation for a period of two immediately preceding financial years and has not made any application within such period for obtaining the status of a dormant company under section 455,

he shall send a notice to the company and all the directors of the company, of his intention to remove the name of the company from the register of companies and requesting them to send their representations along with copies of the relevant documents, if any, within a period of thirty days from the date of the notice.

The Registrar, before initiating an action under this provision, has to follow strictly the procedural requirements, in particular the notice and an opportunity of hearing, which are the canons of natural justice.

Section 252 provides for a remedy of appeal against the Registrar's action of striking off a company. Any person aggrieved by an order of the Registrar, notifying a company as dissolved under section 248, may file an appeal to the National Company Law Tribunal within a period of three years from the date of the order of the Registrar and if the Tribunal is of the opinion that the removal of the name of the company from the register of companies is not justified in view of the absence of any of the grounds on which the order was passed by the Registrar, it may order restoration of the name of the company in the register of companies. But before passing any order under this section, the Tribunal shall give a reasonable opportunity of making representations and of being heard to the Registrar, the company and all the persons concerned.

Natural justice, i. e., rules of fair play, originally developed by the courts of equity to control the decisions of inferior courts and then gradually extended (particularly in the 20th century) to apply equally to the decisions of administrative and domestic tribunals and of any authority exercising an administrative power that affects a person's status, rights, or liabilities. Any decision reached in contravention of natural justice is void as ultra vires. There are two principal rules. The first is the rule against bias—nemo judex in causa sua or in propria causa : no man may be a judge in his own cause. This means that any decision, however fair it may seem, is invalid if made by a person with any financial or other interest in the outcome or any known bias that might have affected his impartiality. The second rule is known as audi alteram partem (hear the other side). It states that a decision cannot stand unless the person directly affected by it was given a fair opportunity both to state his case and to know and answer the other side's case (*Oxford Law Dictionary*).

The Latin maxim "audi alteram partem" which means "here the other side" is one of the basic principles of natural justice. It means no order should be passed to the prejudice of any person unless he has been given a fair and reasonable opportunity of being heard. The set of principles of natural justice is not a codified law or any rigid principles and have undergone a great deal of controversy and judicial review from time to time. The view taken by both Indian and English Supreme Courts, as it prevails presently, is that the principles of natural justice are well applicable to both quasi-judicial as well as administrative orders. The view which prevailed in the past, that the observance of the principles of natural justice is not necessary in administrative enquiries, has lost ground and the Supreme Court of our country has, in a number of recent cases, held that even in administrative orders giving rise to civil consequences the principles of natural justice must be invariably observed. The rules of natural justice aim at preventing arbitrary or unfair exercise of powers by statutory or administrative authorities.

In the case of *A. K. Kraipak* v. *Union of India* reported in AIR 1970 SC 150, the Supreme Court has very aptly summarised this view in the following words :

> "Till recently it was the opinion of the courts that unless the authority concerned was required by the law under which it functioned to act judicially, there was no room for the application of rules of natural justice. The validity of that limitation is now questioned. If the purpose of the rules of natural justice is to prevent miscarriage of justice, there is no reason why those rules should be made inapplicable to administrative enquiries. Often times it is not easy to draw the line that demarcates administrative enquiries from quasi-judicial enquiries. Enquiries which were considered administrative at one time are now being considered as quasi-judicial in character. Arriving at a just decision is the aim of both quasi-judicial enquiries as well as administrative enquiries. An unjust decision in an administrative enquiry may have more far-reaching effect than a decision in a quasi-judicial enquiry."

In yet another case, namely *Kesava Mills Co. Ltd.* v. *Union of India*, AIR 1973 SC 389, the Supreme Court reiterated the above view and observed :

> "The principles of natural justice do apply to administrative enquiries or proceedings. The concept of natural justice cannot be put into a strait jacket. The only essential point that has to be kept in mind in all cases is that the person concerned should have a reasonable opportunity of presenting his case and that the administrative authority concerned should act fairly, impartially and reasonably. Where administrative officers are concerned, the duty is not so much to act judicially as to act fairly."

In the case of *Swadeshi Cotton Mills Co. Ltd.* v. *Union of India* reported in [1981] 51 Comp Cas 210 (SC) this view has further gained firm ground and has been corroborated by the Supreme Court by holding that irrespective of whether the power conferred on a statutory body or Tribunal is administrative or quasi-judicial, a duty to act fairly, that is, in consonance with the fundamental principles of substantive justice, is generally implied, because the presumption is that in a democratic polity wedded to the rule of law, the State or the Legislature does not intend that in the exercise of their statutory powers its functionaries should act unfairly or unjustly . . . if a statutory provision either specifically or by inevitable implication excludes the application of the rules of natural justice, then the court cannot ignore the mandate of the Legislature. It has also been held in that case that the rules of natural justice cannot be ignored wholly and at least a post-decisional hearing must be given.

In *Ostriecher* v. *Secretary of State for the Environment* [1978] 3 All ER 82 (CA) Lord Denning of the England's highest court observed : "It is one of the elementary principles of natural justice, no matter whether it is a judicial proceeding or an administrative enquiry, that everything shall be done fairly ; and that any party or objector should be given a fair opportunity of being heard".

In the case in hand, the Securities and Exchange Board of India (SEBI) initiated proceedings against the petitioner-company by instructing the Bombay Stock Exchange, National Stock Exchange and Metropolitan Stock Exchange to restrict or to suspend trading of shares of the petitioner-company on the basis of a letter dated June 9, 2017 received from the Government of India in the Ministry of Corporate Affairs forwarding the database of 331 listed shell companies in which the company was listed, for initiating necessary action. By an interim order, passed by the SEBI trading in securities of the company was reverted to the original status. It was ordered that stock exchanges would appoint independent auditors to verify misrepresentation of the finance and business of the company as well as misuse of funds and books of account of the petitioner-company. The promoters and directors of the company were permitted only to buy securities of the company, prohibiting them from transferring shares held by them.

On a writ petition the Gauhati High Court held, allowing the petition, that considering the negative implications of being branded a shell company, it was not justified either on the part of the Serious Fraud Investigation Office or the Board to treat the company as a shell company straightaway and thereafter to initiate investigation to justify such branding. The principles of natural justice would require that before such branding, the company should have been put on notice and afforded a reasonable opportunity of hearing as to why and on what grounds it was being suspected to be a shell company and only if the response was found to be not satisfactory, such a finding could have been recorded. The circumstances and the context in which it had been declared a shell company was a virtual condemnation but it was a condemnation without a hearing.

Territorial jurisdiction under section 89 of the Companies Act

Ahmed Abdulla Ahmed Al Ghurair v. *Star Health and Allied Insurance Co. Ltd.* [2019] 213 Comp Cas 462 (SC)

Section 89(1) of the Companies Act, 2013 provides that if the name of a person is entered in the register of members of a company as the holder of shares in that company but who does not hold the beneficial interest in such shares, such person shall make a declaration within such time and in such form as may be prescribed[1] to the company specifying the name and other particulars of the person who holds the beneficial interest in such shares.

Under sub-section (2), the person who holds or acquires a beneficial interest in share of a company shall make a declaration to the company specifying the nature of his interest, particulars of the person in whose name the shares stand registered in the books of the company and such other particulars as may be prescribed.

A person claiming to be a beneficial owner of shares of a company incorporated in India may file a suit for a declaration that he is the true beneficial owner of the shares in question.

But, as held by the Supreme Court in the case in hand, if the person claiming to be the beneficial owner of shares of a company incorporated in India, is a person resident outside India (a citizen of a country other than India), he has to file a suit in a court in that country and not in a court in India. The Supreme Court clarified in such a case :

1. See rule 9 and Form MGT-4, Companies (Management and Administration) Rules, 2014.

"Though respondent No. 1 was an Indian company incorporated in the Indian laws having its registered office at Chennai, the real dispute was between the appellants and respondents Nos. 3 to 7 pertained to the affairs of the Dubai company and in respect of which cause of action had not arisen in Chennai and such a dispute had to be sorted out by the parties between themselves by filing appropriate proceedings in Dubai. The real dispute, thus, was whether respondents Nos. 3 to 7 in whose name shares to the extent of 6.16 per cent. of the Indian company stood, were the real owners or it was the Dubai company which had the beneficial interest in the shares. Even the Dubai company whose beneficial interest was claimed by the appellants was a company incorporated in Dubai. Merely, because the dispute was about those shares which were issued by the Indian company that would not lead to the conclusion that cause of action had arisen in India. The Indian company had nothing to do with the dispute. The relief of declaration which was sought was that respondents Nos. 3 to 7 were not the real owners of such shares and its actual or beneficial owner was the Dubai company. Such a dispute would not bring jurisdiction of Chennai courts simply because the Indian company had its registered office in Chennai."

Whether transfer of pledged shares requires compliance with the provisions of section 56 of the Companies Act

Power Finance Corporation Ltd. v. *Shree Maheshwar Hydel Power Corporation Ltd.* [2019] 213 Comp Cas 491 (NCLT)

Answering this question in the affirmative, the National Company Law Tribunal held in this case that the transfer of shares must be according to section 56 of the 2013 Act. Non-production of the copies of transfer forms either by the petitioner or by the first respondent-company gave rise to adverse inference as to the manner in which the shares were transferred.

Shares are "goods" within the meaning of the Sale of Goods Act, 1930. Section 2(7) of that Act defines the term "goods" as meaning every kind of movable property other than actionable claims and money ; and includes stocks and shares. The shares are movable property under the Companies Act[1]. Shares in companies are, thus, goods under the Sale of Goods Act and a species of movable property.

It is now well-settled that the shares are goods under the Indian Contract Act. In *Kunhunni Elaya Nayar* v. *P. N. Krishna Pattar* [1942] 12 Comp Cas 180 (Mad), this question was considered at length and it was held that there was no valid reason for giving the word "goods" a different meaning in the

1. Section 82 of the 1956 Act (section 44 of the Companies Act, 2013).

Contract Act from the meaning it has in the Sale of Goods Act (Also see *Life Insurance Corporation of India* v. *Escorts Ltd.* [1986] 59 Comp Cas 548 (SC) and *A. M. P. Arunachalam* v. *A. R. Krishnamurthy* [1979] 49 Comp Cas 662 (Mad)). Shares can, thus, be a subject-matter of pledge.

Shares are movable property. In India, shares are goods within the meaning of the Sale of Goods Act. The provisions of the Sale of Goods Act and the Indian Contract Act would apply to a transaction of sale of shares also. Even in respect of transactions of sale of shares, the doctrine of nemo dat quid non habet applies, subject to the exceptions laid down in section 27 of the Sale of Goods Act. Also the provisions regarding pledge of goods under the Indian Contract Act would apply even to a pledge of shares. Under section 176 of the Indian Contract Act the only right of a pawnee is to retain the goods or to sell them after giving to the pawner a notice. The right to sell arises only if there is default in payment or performance. Any sale, in cases where there is no default or without notice would be void. Under section 179 of the Indian Contract Act, the pawnee may create a sub-pledge. But in such cases the only right of the sub-pawnee would be to step into the shoes of the pawnee (*Hindustan Dorr Oliver Ltd.* v. *A. K. Menon* [1994] 80 Comp Cas 384 (Special Court (TORTS))). There can be a mortgage of movables. However, whether there is a pledge or a mortgage is a question of fact. Merely because shares along with blank transfer forms are handed over, that does not mean that automatically the transaction must always be one of mortgage of movables (*Hindustan Dorr Oliver Ltd.* v. *A. K. Menon* [1994] 80 Comp Cas 384 (Special Court (TORTS))).

When the pledged shares are to be transferred to and registered in the name of the pledgee, compliance with the requirements under section 56 is a must. As noted in the Case Law Analysis in Volume 212, the provisions contained in section 56 (like section 108 of the Companies Act, 1956) that a company shall not register a transfer of shares in the company unless a proper instrument of transfer duly stamped and executed has been delivered to the company are, mandatory in character and not merely directory. The Supreme Court has held that the words "shall not . . ." are mandatory in character. Negative, prohibitory and exclusive words are indicative of the legislative intent when the statute is mandatory. Negative words are clearly prohibitory and are ordinarily used as a legislative device to make a statutory provision imperative. The words "shall not register" (in section 108 of the Companies Act, 1956) are mandatory in character. The mandatory character is strengthened by the negative form of the language (*Mannalal Khetan* v. *Kedar Nath Khetan* [1977] 47 Comp Cas 185 (SC)).