

**C.B. Pardhanani and Others Vs. M.B. Pardhanani**

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**Court :** Karnataka

**Decided On :** Mar-26-1990

**Reported in :** [1993]78CompCas540(Kar); ILR1990KAR2604; 1990(2)KarLJ298

**Judge :** K. Shivashankar Bhat, J.

**Acts :** [Companies Act, 1956](#) - Sections 397, 398 and (1), 399, 400, 402, 406, 433, 538, 539, 540, 541, 542, 543 and 544

**Appellant :** C.B. Pardhanani and Others

**Respondent :** M.B. Pardhanani

**Advocate for Def. :** Udaya Holla, Adv.

**Advocate for Pet/Ap. :** S.S. Naganand, Adv.

**Judgement :**

**K. Shivashankar Bhat, J.**

1. This petition which purports to be under section 398 of the [Companies Act, 1956](#) ('the Act', for short), seeks the following reliefs against the respondent :

'(1) to declare that the respondent is guilty of acts of mismanagement and misappropriation and is a recipient of illegal gratification while in the management of Mac Charles (India) Ltd.;

(2) direct the respondent to restore to Mac Charles (India) Ltd., the sum of Rs. 44,78,000 or such other sum as may be found due to the company in respect of such acts of mismanagement, misappropriation and illegal gratification indulged in while in the management of the company ;

(3) punish the respondent under sections 539, 540, 541, 542 and 543 of the [Companies Act, 1956](#) (read with Schedule XI), and award such imprisonment as this hon'ble court deems just and appropriate ;

(4) remove the respondent from the office of director of the company ;

(5) pass temporary injunction restraining him from attending the board meeting of the company ;

(6) disqualify the respondent from holding any office of director in the company ;

(7) for costs of these proceedings and for interest on sums which the respondent is directed to restore to the company ; and

(8) grant such other and further reliefs as this hon'ble court deems fit to grant in the facts and circumstances of the case.'

2. According to the petitioners, the respondent who was the managing director of the third petitioner company, resigned from the office of managing director in May, 1987, and, thereafter, did not attend any of the board's meetings. Subsequently, an extraordinary general body meeting was convened to remove him from the office of the director ; the meeting was scheduled to be held on December 21, 1987, but was not held in view of a civil court's order. The shareholding of the respondent is only 1.28 percent. which he holds in trust and for the benefit of the second petitioner. The application for temporary injunction was subsequently withdrawn in the civil suit and, in the adjourned meeting held on January 18, 1988, the respondent was removed from the office of the director. The present petition was filed on August 27, 1988. The first petitioner is the director and chairman of the company. The company was impleaded as a party. The petition proceeds on the clear assumption that petitioners Nos. 1 and 2 hold a controlling interest in the company and the respondent ceased to be in charge of the company's

management and its affairs. Several acts of commission and omission are alleged against the respondent while he was allegedly in control of the affairs of the company and was its managing director. In view of the misfeasance committed by the respondent, the company is alleged to have suffered a huge loss.

3. It is not necessary to refer to the details given in the petition. The respondent, however, has denied the allegations made against him ; on the other hand, he attributes several acts of omissions to the first petitioner, resulting in loss to the company ; he further asserts that the first petitioner has been guilty of enriching himself at the cost of the company.

4. There are a few more litigations between the parties. Being brothers, the first petitioner and the respondent may be expected to proceed with a bitter fight against each other.

5. The petition is not yet admitted. the respondent has raised a preliminary objection as to the maintainability of the petition under section 398 of the Act. According to the respondent, the relief is sought against a person who is not in the management of the company and admittedly is not controlling its affairs. Petitioners Nos. 1 and 2 are in present management. The question of any oppression by the respondent of the other shareholders does not arise here. The reliefs sought are in the nature of compensation for the past alleged tortious acts and seeks punishment to be imposed on the respondent. The reliefs sought in no way reflects the relief contemplated by section 398 of the Act.

6. Some of the acts and omissions attributed to the respondent are : (a) that the respondent was the managing director at the relevant time and was responsible for the delay in the execution of the hotel project ; (b) that the respondent abused his authority as managing director by placing orders for materials without disclosing the same to the other directors ; (c) that the respondent, as the managing director, made certain fraudulent appointments, to his favorites, on exorbitant remunerations ; and (d) that the respondent was guilty of embezzlements and misappropriations.

7. All these are alleged to have resulted in loss to the company and are prejudicial to the interest of the public and of the company and its members.

8. The question to be considered at the outset, therefore, is whether this petition is maintainable under section 398 of the Act.

9. Section 398 reads :

'398. Application to court for relief in cases of mismanagement.- (1) Any members of a company who complain-

(a) that the affairs of the company are being conducted in a manner prejudicial to public interest or in a manner prejudicial to the interests of the company ; or

(b) that a material change (not being a change brought about by, in the interests of, any creditors, including debenture-holders, or any class of shareholders, of the company) has taken place in the management or control of the company, whether by an alteration in its board of directors, or of its managing agent or secretaries and treasurers or manager, or in the constitution or control of the firm or body corporate acting as its managing agent or secretaries and treasurers, or in the ownership of the company's shares, or if it has no share capital, in its membership, or in any other manner whatsoever, and that by reason of such change, it is likely that the affairs of the company will be conducted in a manner prejudicial to public interest or in a manner prejudicial to the interests of the company may apply to the court for an order under this section, provided such members have a right so to apply in virtue of section 399.

(2) If, on any application under sub-section (1), the court is of the opinion that the affairs of the company are being conducted as aforesaid or that by reason of any material change as aforesaid in the management or control of the company, it is likely that the affairs of this company will be conducted as aforesaid, the court may, with a view to bringing to an end or preventing the matters complained of or apprehended, make such order as it thinks fit.'

10. Mr. Udaya Holla contended that the purpose of section 398 is to bring to an end or prevent the matters complained of or apprehended, and its object is not to

take up the past and to compensate any alleged loss caused to the company in the past ; a mere superfluous proceeding is not contemplated by it. Like section 397, this provision also is attracted only as a preventive measure. Mr. Naganand, learned counsel for the petitioner, however, contended that section 398 has to be read with section 406 of the Act and, consequently, Schedule XI to the Act gets attracted ; by virtue of Schedule XI, any officer or member of a company in respect of which an application has been made under section 397 or 398 is liable to be punished or penalised ; such a person could be fastened with liability for fraudulent conduct of business and the court may also assess damages against such a person ; for these purposes, Schedule XI is incorporated with suitably modified provisions of sections 539 and 544 of the Act. A person who has been guilty of misfeasance, or defrauded the company while in office, cannot escape these liabilities by just resigning from office. According to Mr. Naganand, the present management of a company can invoke section 399 and Schedule XI to the Act against any past officer of the company and to effectuate the provisions contained in Schedule XI, it is necessary to interpret section 399 so as to uphold the maintainability of an application by the present management.

11. Mr. Naganand's contention incorporates the provisions of Schedule XI into section 399, and makes them part of the latter's substantive elements. Section 539 says that it is attracted on an application made under section 398. Similarly, section 543 says that, 'if in the course of the proceedings on an application made to the court under sections 397 and 398, it appears that any person,...etc.' In other words, these provisions of Schedule XI get attracted only in the course of a main application under section 397 (or section 398). The proceedings under the provisions of several sections stated in Schedule XI are to be subsequent to the lodging of the main application under section 399 ; they are only incidental or ancillary to the main proceedings ; they are actually comparable to the proceedings envisaged by sections 539 to 544 as found in the body of the Act (i.e., those sections as found immediately after section 538 in the Act); those proceedings contemplated by the main sections 539 and 543 are the off-shoots of winding up proceedings, i.e., subsequent to the stage of section 433 and other provisions governing the filing and hearing of a petition for winding up. If the fraudulent conduct of the past director by itself cannot be a ground for the winding

up of a company under section 433, by the same analogy, it has to be held that the past conduct of an ex- officer of the company who is not presently controlling the affairs of the company cannot by itself constitute a cause of action for filing an application under section 399 by the present management.

12. This interpretation, according to Mr. Naganand, would defeat the purpose of the Act and enable delinquent officers of the company to get away with their misdeeds.

13. That is not so. Any fraudulent or tortious act on the part of an 'officer' of the company resulting in loss to the company would give rise to a cause of action to sue him for appropriate reliefs. Similarly, if the fraud or misconduct alleged is of such a nature, in appropriate cases, criminal law can also be put in motion against him. Neither the law nor the company is helpless to vindicate itself in these matters. The procedure of those civil and criminal cases may be read the statutory provision like section 399 differently from what it conveys.

14. Section 398 is already extracted above. The application under it is for relief 'in cases of mismanagement'. Any member of the company may complain to the court. The subject of complaint is to be that the affairs of the company are being conducted in a manner prejudicial to public interest, etc. It is in the present tense. At the time of the application, the affairs of the company are to be conducted in a manner prejudicial to public interest, etc. It does not say that, 'the affairs of the company are or were being conducted...'

15. Section 398 is the twin provision to section 397 ; the object is to provide a further remedy to a member of the company, in respect of matters not covered by section 397. Though most of the provisions of our Companies Act bear similarly to the English Companies Act, there is no provision in the English Act similar to section 398. Sub-clause (b) of section 398(1) throws much light on sub-clause (a). Sub-clause (b) is attracted when a material change takes place in the management or control of the company and, by that change, it is likely that the affairs of the company will be conducted in a manner prejudicial to public interest, etc. while section 398(1)(a) provides a remedy against the present management, sub-clause (b) provides for a remedy consequent upon a change in the

management or control of the company. This is made clear by sub-section (2) itself. The order of the court is to bring to an end or prevent the matters complained of. To bring to an end a thing or matter, that thing or matter should be in existence, at least on the date of the application for such a relief.

16. Schedule XI to the Act is attracted only when, in proceedings under section 398, certain misfeasance, breach of trust or fraud comes to light. The several provisions contained in Schedule XI contemplate further independent proceedings against the person found to have been guilty of misfeasance, etc., in the course of the main proceedings under section 398. Section 398 nowhere states that a member of the company may apply under section 398 to take action against the past management or officer of the company so as to reimburse the company for any loss caused to it.

17. Section 402 also is relevant here. It enunciates the power of the court on an application under section 397 or 398. None of the clauses (a) to (g) specifically empower the court to take penal or civil action against the past management or officer of the company, on an application under section 397 or 398.

18. The powers vested in the court under section 398 are not only discretionary ; they are designed to remove an existing oppressive or prejudicial course of conduct of the affairs of the company and are not concerned with the past management except where the past projects itself as a continuing wrong and pervades the present conduct of the company's affairs.

19. A few decisions cited by learned counsel for both sides require to be considered.

20. *Jermyn Street Turkish Baths Ltd., In re* [1971] 41 Comp Cas 999, is a decision of the Court of Appeal (England). It is concerned with the concept of oppression in relation to the director's remuneration, i.e., when an excessive remuneration drawn by or paid to a director amounts to oppression of the minority.

21. *Dr. V Sebastian v. City Hospital P Ltd.* [1985] 57 Comp Cas 453 is a decision of the Kerala High Court. It is said there, that, even a majority of members of a

company may complain of oppression by the minority shareholders and seek relief from the court.

22. Shanti Prasad Jain v. Kalinga Tubes Ltd. : [1965]2SCR720 , was cited by Mr. Udaya Holla to contend that sections 397 and 398 cannot be invoked by the majority shareholders as the object behind these provisions is to protect the minority against the oppressive conduct of the majority. The concept of oppression has been elucidated in the said decision, thereafter, at page 1543, the Supreme Court held (at page 366 and 367 of 35 Comp Cas) :

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

23. Some of the observations no doubt indicate that the provisions of section 397 can be invoked only by the minority shareholders. But it is possible to take the view that these observations were made in the context of the facts of the said case. It is unnecessary in the instant case, for me to consider this proposition,

having regard to the conclusion arrived at by me, as to the scope of section 398. One sentence in the above observation of the Supreme Court is very relevant. It says that (at page 366) :

'There must be continuous acts on the part of majority shareholders, continuing up to the date of petition, showing that the affairs of the company were being conducted in a manner oppressive to some part of the members.' (underlining\* is done here)

\* Here printed in italics.

24. The crucial words in the opening sentences of sections 397 and 398 are substantially similar, i.e., any members of a company who complain that the affairs of the company 'are being conducted', etc., and it is this structure of the sentence that gave rise to the above observation of the Supreme Court.

25. Some of the observations in *Colaba Land and Mill Co. Ltd. v. Vasant Investment Corporation Ltd.*, : AIR1964 Guj107 , may aid the proposition advanced by Mr. Naganand. Though the learned judge observes there that a proceeding under section 543 emanates from a proceeding under sections 397 and 398, and that prima facie, the enquiry under sections 397 and 398 has no connection with the enquiry under section 543 (Schedule XI), the proceeding initiated under section 543 was retained for further consideration, even after the relevant prayer concerning sections 397 and 398 was not pressed. An important aspect of the said case was that the proceeding under sections 397 and 398 had substantially taken place and evidence has been recorded even in respect of allegations falling under section 543. The persons against whom complaints were made were in the management and control of the affairs of the company when the main petition under section 397 and 398 was filed. Therefore, as on the date of the application, the allegation was that the affairs of the company 'are being conducted' in a manner prejudicial to public interest or to the interest of the company, etc. Therefore, the petition, as such, was maintainable at time when it was filed and entertained. In this background, the observations found at page 112, are to be held as obiter or as irrelevant to the facts of the instant case before me. The said observations are (at page 112) :

'Therefore, all that an applicant under section 543 (Schedule XI) has to satisfy, when presenting an application under section 543 (Schedule XI) is that a case for misfeasance has come to light in the course of a petition under section 397 or section 398. Therefore, from one point of view, the moment the present petition was filed and allegations came to be made against respondents Nos. 2 to 4 that they were guilty of misfeasance, a right to present an application under section 543 (Schedule XI) accrued to a creditor or member of the respondent company and, therefore, it is necessary that the present petition must be retained on the file, in order to enable either the petitioner company or any other creditor or member of the respondent company to make that application.'

26. The subsequent discussion also supports my view in this regard. At page 113, the court said :

'I have no doubt whatsoever that a proceeding under section 397 or section 398 of the Act cannot be said to have started unless the petition under that section has come to be filed, numbered, and at least, some order of the court is obtained thereon. Till that stage, it cannot be said that a proceeding under section 397 or section 398 of the Act has started. In this view of the matter, it appears to me to be crystal clear that petitions under sections 397 or 398 and 543 (Schedule XI) cannot be combined together or simultaneously made, but that the petition under the latter section must follow after a prima facie case has come into light in the course of the proceedings under the former sections.'

27. In other words, until an application under section 398 is entertained and some order is obtained thereon, there cannot be a proceeding at all under section 398. Here, in the instant cas, the respondent has raised the preliminary objection even at the threshold. The petition has not yet been formally admitted. The Central Government also has not been notified as required by section 400. Therefore, even if those observations of the Gujarat High Court (at page 112) are to be applied, read with the further observations extracted above, it cannot be said that the petitioners herein can invoke the provisions contained in Schedule XI for the purpose of an application under section 398.

28. Sheth Mohanlal Ganpatram v. Shri Sayaji Jubile Cotton and Jute Mills Co. Ltd. [1964] 34 Comp Cas 777 ; AIR 1965 Guj 96, does not give the entire facts ; nor the complete judgment. It was rendered by Justice P N Bhagwati (as his Lordship then was). The question posed was (at page 802 of 34 Comp Cas) :

'Does the power of the court extend to the making of an order, setting aside or interfering with past and concluded transactions between a company and a third party which are no longer continuing wrongs or is the power of the court confined to the making of an order preventing future oppression or mismanagement? Mr. S B Vakil, learned advocate appearing on behalf of the petitioners, pleaded for the former construction on the ground that such construction would enlarge the power of the court rather than limit it and in support of this plea he relied on the well-known rule of interpretation that in the case of provisions of a remedial nature, which sections 397 and 398 undoubtedly were, the construction to be made should be such as will suppress the mischief and advance the remedy and add force and life to the cure and remedy according to the true intent of makers of the Act, pro bono publico. Now Mr. S B Vakil is certainly right in his submission that sections 397 and 398 being designed to suppress an acknowledged mischief, they should receive liberal interpretation and the court should give such construction as will advance the remedy, but even applying this principle of interpretation, it is not possible to accept the construction contended for on behalf of the petitioner.'

29. Again, at page 100, it was observed (at page 805 of 34 Comp Cas):

'The language of sections 397 and 398 leaves no doubt as to the true intendment of the Legislature and it is transparent that the remedy provided by these sections is of a preventive nature so as to bring to an end oppression or mismanagement on the part of controlling shareholders and not to allow its continuance to the detriment of the aggrieved shareholders or the company. The remedy is not intended to enable the aggrieved shareholders to set at naught what has already been done by controlling shareholders in the management of the affairs of the company. If such were the intention of the Legislature, which as I will presently show it could never have been, the language of sections 397 and 398 would have been different and the Legislature would not have confined the power of the court

by limiting the purpose for which it can be exercised under the sections.'

30. However, Mr. Naganand referred to para 35, wherein it was held that (at page 812 of 34 Comp Cas) :

'The court can, therefore, in cases covered by section 543, as set forth in Schedule XI award, on an application under section 397 or 398, at the instance of the aggrieved shareholders, compensation to the company and through the company to the aggrieved shareholders, in respect of past and concluded transactions which are not continuing wrongs. Just as clause (f) of section 402 enables the court to set at naught transactions amounting to fraudulent preference effected within three months before the date of the application under section 397 or 398, even though they are no longer continuing wrongs, so also, section 406 enables the court to award compensation in respect of past and concluded transactions falling within section 543 as set forth in Schedule XI, even though they are no longer continuing wrongs. These are the only two cases in which, on an application under section 397 or 398, the court is empowered to give relief in respect of past and concluded transactions which are no longer continuing wrongs and they are really in the nature of exceptions to the general principle manifest from the language of sections is confined only to making an order for the purpose of putting an end to oppressive or prejudicial conduct and the court cannot make an order setting aside or interfering with past and concluded transactions which are no longer continuing wrongs or giving compensation to the company or the aggrieved shareholders in respect of such transactions.'

31. This observation was made under a different context altogether. The court was not concerned there with the maintainability of the petition under section 398, wherein, the substantial prayer was to take action against the person who was in the control of the company's affairs in the past, and the relief sought there was against the existing management. The court was considering, broadly, the amplitude of the court's powers in a proceeding under section 398.

32. The prayers made in the instant case, while invoking section 398, are outside the scope of the said provision, when, admittedly, the reliefs are sought against the respondent who is not in management or control of the company ; they may

fall under Schedule XI to the Act, but, that by itself would not make the application under section 398 maintainable.

33. In the result, for the reasons stated above, this petition is rejected in limine. No order as to costs.

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