

Mrs. U.A. Sumathy and anr. Vs. Dig Vijay Chit Fund (P.) Ltd.

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Court : Kerala

Decided On : Jul-01-1980

Reported in : [1983]53CompCas493(Ker)

Judge : M.P. Menon, J.

Acts : [Companies Act, 1956](#) - Sections 237 and 242 to 244

Appeal No. : Company Petition No. 23 of 1978

Appellant : Mrs. U.A. Sumathy and anr.

Respondent : Dig Vijay Chit Fund (P.) Ltd.

Advocate for Def. : Mani J. Meenattoor, Adv.

Advocate for Pet/Ap. : M. Ramanatha Pillai, Adv.

Disposition : Petition dismissed

Judgement :

M.P. Menon, J.

1. This is a petition filed by the two members of the Dig Vijay Chit Fund (P.) Ltd. under Section 237 of the [Companies Act, 1956](#), for a declaration that the affairs of the company require investigation by an inspector appointed by the Central Govt.

2. The main business of the company is in kuries and in money-lending. The first petitioner, along with six other shareholders, had earlier filed a petition for winding up it, but that was dismissed on the ground that they had other remedies, and that the prayer for winding-up was unreasonable in the circumstances disclosed. The present is a resort to one of the other remedies available.

3. The allegations in the petition are broadly the following : The chief agent and the directors of the company are utilising their position to oppress the other shareholders. The chief agent and his relatives hold 72 shares and the directors control another 122. In April, 1972, the company fraudulently sold 64 shares, belonging to seven members, who were not supporting the directors ; and these shares were purchased by the relatives of the directors and the chief agent. The group in management has 'been misappropriating the company's funds, destroying valuable records to cover up their misdeeds, causing loss to the company by declining to proceed against debtors, and writing off bad debts after privately collecting amounts from the concerned debtors. Some particulars relating to the alleged misappropriation, destruction of records, etc., are furnished, and there is also a general allegation that the company has been incurring losses as a result of all the above.

4. The company has denied all these allegations in its counter-affidavit. The 2nd petitioner has been examined as P.W. 1 and Exs. A-1 to A-6 have been marked on the side of the petitioners. The company has examined its

present managing director as R.W. 1, and marked Exs. B-1 to B-7.

5. Sections 235 - 246 of the [Companies Act, 1956](#), deal with the investigation of the affairs of a company. Under Section 235, the Central Govt. is given power to appoint inspectors for the purpose ; and the power is to be exercised either on the application by members or on the basis of a report by the Registrar under Section 234. Section 236 provides that members applying under Section 235 should furnish evidence to show that they have ' good reason for requiring the investigation '. Clause (a) of Section 237 obliges the Central Govt. to arrange for an investigation when the company, by special resolution, or the court, by order, declares that an investigation is called for, while Clause (b) confers a discretion on the Government to do so when the circumstances enumerated thereunder are found to exist. Sections 238 - 241 deal with inspectors, their powers and the report they have to make. Sections 242 - 244 specify the follow-up measures the government could take on the basis of the reports. Prosecution of persons found criminally liable, moving the court for winding-up or for relief from oppression, and initiation of misfeasance and other proceedings are some of the measures contemplated. Section 245 provides for the expenses of investigation, and Section 246 declares that the inspectors' reports shall be admissible as evidence in legal proceedings. An analysis of the above provisions indicates that appointment of inspectors is a matter in the discretion of the Govt. under Section 236, and also Clause (b) of Section 237 ; but in cases governed by Section 237(a), the Government has a duty to act. The machinery for inspection could be set in motion on the request of members under Section 236, only when a certain percentage of the total number of members apply ; the Central Govt. cannot act when the strength of those who apply is below the minimum prescribed. But what about an application to the court under Section 237(a)(ii) Can the court order an investigation irrespective of the number of members who seek to invoke its power

6. Section 237 does not in terms speak of an application to be filed in court; but Rule 11(a)(9) of the Companies (Court) Rules, 1959, conceives of such an application. In *Raghunath Swarup Mathur v. Har Swamp Mathur* [1970] 40 Comp Cas 282, the Allahabad High Court observed thus (at p. 296):

' As the declaration sought amounts to a direction to the Central Government, it should only be granted either where a party, having applied to the Central Government for an investigation, has failed despite sufficient grounds shown for it, or, when the court finds that a proceeding before it, under either Section 397 or Section 398 of the Act, cannot satisfactorily terminate without such an investigation. '

7. But it appears from the decision of the Delhi High Court in *Delhi Flour Mills Co. Ltd., In re* [1975] 45 Comp Cas 33, that a prior application to the Central Govt. under Section 236, or the pendency of proceedings under Sections 397 and 398, are not conditions precedent for exercising the court's power under Section 237(a)(ii). The Delhi case had arisen from an application filed by a single shareholder ; and it is also not contended before me that the numerical strength of the members, who move the court under Section 237, should satisfy the minimum prescribed by Section 235.

8. The present proceedings are only for the purpose of deciding whether the affairs of the company should be looked into by the inspectors. And, according to counsel for the petitioners, it is not necessary for his clients to prove their allegations before this court; they could prove them before the inspectors. No doubt, Clause (a) (ii) of Section 237 does not lay down what circumstances are to be proved before the court and on what materials the court could act. But that does not mean that mere allegations are sufficient. A court can act only on the materials placed before it; and those materials should at least be such as to satisfy the court that a deeper probe into the company's affairs is desirable in the interests of the company itself. According to the Delhi High Court in *Delhi Flour Mills Co. Ltd.'s, case* [1975] 45 Comp Cas 33 (Delhi), noticed above, the materials should be such as would result in proceedings being taken under Sections 242 - 244 ; no investigation could be ordered merely because a shareholder feels aggrieved about the manner in which the company's business is being carried on. The scope of Section 237 was considered by me in *C. P. No. 22 of 1978* decided on 29-1-1980. [*P. Sreenivasan v. Yoosuf Sagar Abdulla & Sons (P.) Ltd.* [1983] 53 Comp Cas 485 (Ker)], in the following terms (at p. 489):

' The section conceives of three situations where the Central Government can appoint inspectors for investigation. The first is when the company itself declares that such an investigation is necessary. The second is when the court makes an order. And the third is when the Central Govt. forms an opinion that the circumstances enumerated in Clause (b) exist, The first is easy to understand ; when the company itself wants an investigation, the Central Govt. need not stop to enquire why. The third can also be understood because when suo motu action is proposed to be taken by the Government, it shall not act arbitrarily, but only consistent with the guidelines laid down. But what about the second situation, where the court has to make an order Mr. Ramanatha Pillai for the petitioner suggests that the power and the discretion of the court are uncontrolled ; it can direct an investigation whenever it suspects that all is not well with the company. Whether the apprehensions of the court are true or not is a matter to be found by the investigating inspectors, and the court is not to insist on evidence. It appears to me that this is too broad a statement. Investigation of the company's affairs by the Department of Trade in England has always been understood as a statutory exception to the rule in *Foss v. Harbottle* [1843] 2 Hare 461, that the internal affairs of a company is a matter for the majority, and a dissatisfied minority cannot seek outside interference. The Companies Act provides for the protection of minorities in three ways : (i) by giving them a right to complain against oppression, (ii) by permitting them to act on behalf of the company when it is wound up, as in the case of misfeasance proceedings, and (iii) by enabling them to obtain remedies indirectly through investigation. The court's discretion under section 237 is, therefore, to be exercised only when it is satisfied that the minority has made out at least a prima facie case that the rule in *Foss v. Harbottle* [1843] 2 Hare 461, requires relaxation in the interests of the company. The Calcutta High Court has held in *In re Patrakola Tea Co. Ltd.*, AIR 1967 Cal 406, that before the company, court orders an investigation under Section 237(a)(ii), the petitioner should make out a strong case in relation to one or other of the matters referred to in clause (b). In other words, the circumstances enumerated in Clause (b) are material for the exercise of the court's discretion also. The discretion is certainly a judicial one and is to be exercised only when a minority acts in the interests of the company as a whole.'

9. It is in the above background that I propose to examine the allegations made and the evidence adduced herein.

10. As regards misappropriation, two specific instances are referred to in para. 5 of the petition. The first is that in 1971, the then managing director, Sri Chandrasekharan, had drawn an amount of Rs. 3,000 from the ' Anamath account' when there was no deposit with the company in his name. The company's answer in para. 8 of its counter-affidavit is that Mr. Chandrasekharan had drawn an amount of Rs. 3,000 on September 23, 1971, when he had a credit balance of only Rs. 602.99, but that he had subsequently made deposits of Rs. 1,534 and Rs. 2,300 in November and December, 1971. The correctness of this statement is not disputed in the petitioners' reply affidavit. And a mere entry in the suspense account is not sufficient to establish misappropriation. The concerned account books have not been called for ; and neither Mr. Chandrasekharan nor the person who made the entry has been cited to explain it. No attempt has also been made to bring out what the powers of the managing director were in matters of this kind. P. W. 1, who was himself a managing director of the company for some time, made only a bare reference to the entry in the course of his evidence; he did not even say that the amount was misappropriated or lost to the company.

11. The second instance relates to the compromise effected in O.S. 137/70, filed by the company against one Francis for the recovery of Rs. 680 ; and the allegation is that the party had produced a receipt showing that the amount had been paid personally to the managing director, Mr. Namboodiri-pad, and that the suit was compromised without crediting the amount in the company's accounts. But the documents produced tell a different tale. Exhibit B-1 dated November 16, 1970, discloses that P.W. 1, who was then the managing director of the company, had authorised R.W. 1, who was then its secretary, to compromise the suit, though the party had produced a ' false receipt '. Exhibit B-3 shows that an amount of Rs. 498 was credited in P.W. 1's suspense account with the company on the next day. According to R.W. 1, the party had produced in court a false receipt and when he was threatened with criminal action, he offered to settle the matter by paying Rs.

500. The matter was settled with the concurrence of P.W. 1 and the amount (less Rs. 2 for expenses) was credited in his suspense account as per Ex. B-3, pending filing of a compromise petition before the court. Exhibit A-2 is a certified copy of the compromise petition filed on November 6, 1971, and Ex. A-1 is a compromise decree. The petitioners' case that Sri Namboodiripad had received payment and issued a receipt and that the suit was compromised when this was brought to light, does not stand scrutiny in the light of the admitted circumstance that P.W. 1 himself was aware that the receipt was a false one and that the compromise was effected on the footing that it was not genuine. Mis-appropriation is a serious matter, and the evidence available is insufficient to establish even a prima facie case.

12. The allegations relating to destruction of records and the fraudulent transfer of the 64 shares were not pursued at the time of hearing. P.W. 1 did not in his evidence even make mention about the destruction of any records ; and a suggestion thrown at R.W. 1 during his cross-examination about ' removal ' of records was promptly dented. The same is the position regarding the 64 shares said to have been fraudulently transferred.

13. The next allegation relates to the writing off of Rs. 22,074 and Rs. 14,476, respectively, as bad debts, in the profit and loss account marked as Exs. A-4 and A-5 ; and the case attempted to be made out is that the directors and the chief agent had actually received payment of the amounts and had thereafter attempted to cover up the misappropriation by making it appear that they were bad debts. Exhibits A-4 and A-5 do show that the amounts were written off; but there is nothing but the assertion of P.W. 1 to suggest that any officer of the company had actually received payments as alleged. P.W. 1 stated in cross-examination that the amounts written off included Rs. 800 due from one Sachidanandan, Rs. 750 from Ummer, Rs. 600 from Ayyappan and Rs. 700 from Madhavan ; but Sachidanandan alone had told him that he had paid the amount to the company. P.W. 1 had no other knowledge or information about the alleged payments. The company's case, on the other hand, is that the amount written off in Ex. A-4 represents arrears of kuri collections and amounts due under promissory notes from over 400 persons, considered as irrecoverable. The company had conducted more than 100 chitties and made a large number of other advances; and some amounts were being written off from time to time. Exhibit B-4, the minutes book, indicates that the amount was written off as per Board's resolution dated November 9, 1973. Exhibit A-4, the audited accounts, must have been approved by the general body also. That apart, the list of bad debts referred to in the Board's resolution is Ex. B-5 and it contains particulars of 446 debts due from chit subscribers, the amounts varying from Rs. 2.50 to Rs; 118. Sachidanandan's name is not there, and no debt exceeding Rs. 118 is seen written off. The debts in Ex. A-5 were also written off by a Board's resolution, and, according to R.W. 1, those were amounts due from employees (bill collectors), who were going about making collections. They had left the services of the company and they had no assets. It is usual for men in a business of this type to periodically write off irrecoverable debts. In the present case, it was done by resolutions duly passed by the Board, and obviously approved by the general body of members. The accounts were duly audited and filed with the Registrar. The evidence is totally insufficient to raise even a serious suspicion that anything else had been done.

14. The only other point raised is that the company has been incurring loss year after year ; but no investigation could be, ordered unless that result is linked with fraud, misfeasance, mismanagement, oppression and the like. The loss might be an ordinary business risk. It may be noticed that the company's paid up capital and membership have risen by at least one hundred per cent. between 1976 and 1978. The petitioners are only two out of 1,312 members. The company has also a case that the first petitioner is the wife of a dismissed employee and that the 2nd is annoyed by a notice demanding payment of some amounts due from him. It is unnecessary to go into this aspect because, even otherwise, the attempt of the petitioners has only been to show that something suspicious had taken place between 1971 and 1975.

15. In my view, therefore, no case for the issue of a direction under Section 237(a)(ii) is made out, and the petition has to fail. It is accordingly dismissed, but without any order as to costs.

