Dale And Carrington Invt. P. Ltd. And ... vs P.K. Prathapan And Others on 13 September, 2004

Equivalent citations: AIR 2005 SUPREME COURT 1624, 2005 (1) SCC 212, 2004 AIR SCW 5143, 2005 CLC 449 (SC), 2004 (62) CORLA 245, 2004 (4) CURCC 91, 2004 (7) ACE 282, 2004 (7) SUPREME 209, 2004 (4) COM LJ 1 SC, 2004 (7) SCALE 584, 2004 (8) SRJ 461, (2004) 7 JT 434 (SC), 2004 (7) JT 434, 2004 (5) SLT 784, (2004) 4 KHCACJ 50 (SC), (2004) 4 CTC 619 (SC), (2004) 4 COMLJ 1, (2004) 2 HINDULR 361, (2004) 7 SCALE 584, (2004) 2 KER LT 170, (2004) 3 RECCIVR 448, (2005) 2 MAD LJ 10, (2004) 1 CIVILCOURTC 571, (2003) 3 RAJ LR 650, (2004) 3 KER LT 475, (2004) 22 INDLD 1, (2004) 122 COMCAS 161, (2004) 19 ALLINDCAS 950 (KER), (2004) 3 CIVLJ 571, (2004) 1 RAJ LW 158, (2003) 3 WLC (RAJ) 784

Author: Arun Kumar

Bench: Ruma Pal, Arun Kumar

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           CASE NO.:
Appeal (civil)  5915-5916 of 2002

PETITIONER:
DALE AND CARRINGTON INVT. P. LTD. AND ANOTHER

RESPONDENT:
P.K. PRATHAPAN AND OTHERS

DATE OF JUDGMENT: 13/09/2004

BENCH:
RUMA PAL & ARUN KUMAR

JUDGMENT:
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JUDGMENT 2004 Supp(4) SCR 334 The Judgment of the Court was delivered by ARUN KUMAR, J.: P.K. Ramanujam, appellant 2 and P.K. Prathapan and his wife Pushpa Prathapan, respondents l and 2 are the contesting parties in this litigation. Appellant l is the company in which they are all shareholders and the litigation is about its control and management. Both parties are making claim to the right to control and manage the company. Briefly the facts are : Ramanujam had returned to kerala, his native place, after resigning his job as an accountant in England in the year 1983. He was looking for an opportunity to work. Prathapan, also native of Kerala, had been working in Muscat since long and was staying there alongwith his family. The mother of Parthapan, named Kalyani Kochuraman, was living in Kerala. Prathapan had two sons. According to Prathapan his sons were

desirous of returning to India and settling down in their native place. Therefore, Prathapan wanted to set up some business in India in order to settle his sons. Since the parties are relations they were in touch with each other. Towards the middle of 1987 Ramanujam informed Prathapan that a hotel called 'Hotel Siddharth' in a town called Chalakudy, was available for sale. The hotel building had ten rooms, besides a restaurant with a bar attached to it. The partners who were running the hotel were interested in selling it immediately. Ramanujam further informed Prathapan that the hotel was available for down payment of Rs. 6 lakhs (Rupees six Lakhs). The purchaser, in addition, had to take upon a liability of about Rupees 18 lakhs (Rupees eighteen lakhs) which was standing on the hotel. Ramanujam offered to look after the business of the hotel till Prathapan decided to return to India. The parties decided to go ahead with the purchase of the hotel for which Prathapan agreed to send Rs. Five Lakhs. Ramanujam was to get a salary for the services to be rendered by him in looking after the business of the hotel. A company by the name of Dale and Carrington Investments Private Limited was incorporated on 4th November, 1986 for the hotel business. Ramanujam and his wife Draupathy were shown as the promoters of company. On the request of Ramanujam, Prathapan sent a Bank Draft in the sum of Rs. 5 lakhs (Rupees Five Lakhs) favouring his mother Kalyani Kochuraman on 3rd March, 1987. The draft was sent in the name of the mother because Prathapan was an NRI and the company could not receive money directly form him. The device of money being first sent in the name of Prathapan's mother and thereafter the mother transferring it to the company, was suggested by Ramanujam in his letter dated 25th February, 1987 to Prathapan. The Hotel was accordingly acquired by the company in March, 1987. A sum of Rs. 6 lakhs (Rupees Six Lakhs) was required to be paid in cash to the vendors out of which Rs. 5 lakhs (Rupees five lakhs) were received from Prathapan and a sum of Rs. 50,000 (Rupees Fifty Thousand) was invested by Muralidharan, brother of Prathapan. The rest of the amount came from other respondents. There was no financial contribution by Ramanujam. Initially Ramanujam and his wife Draupathy were the Directors of the company. However in December, 1988 Draupathy was dropped as Director and in her place Muralidharan, brother of Prathapan and Suresh Babu, brother of Prathapan's wife, were taken as Directors of the Company. 5000 (five thousand) equity shares worth Rupees five lakhs were allotted in the name of Smt. Kalyani Kochuraman, mother of Prathapan against the investment of Rupees Five Lakhs. These 5000 equity shares were subsequently transferred in the name of Prathapan and his wife, 2500 (two thousand five hundred) each, subject to the transferees obtaining requisite permission of the Reserve Bank of India under the Foreign Exchange Regulation Act (FERA). The transfer of shares in the name of Prathapan and his wife Pushpa was duly record in the Register of Members maintained by the company. Thus Prathapan and his wife Pushpa became shareholders of the company to the extent to 2500 equity shares each.

Initially the company was making losses. However, by about year 1991-92, the company turned the corner. Copies of balance sheets of the company for a few years of its working have been placed on record by the appellant which show that till 31st March, 1992 there were no profits in the company. For the first time some profits was shown as on 31st March, 1993. Till 31st March, 1993, under the head 'Advance towards share capital pending allotment' only a sum of Rs. 3000 (Rupees Three Thousand) was shown whereas as on 31st March, 1994 under the said head, a balance of Rs. 6,86,500 (Rupees six lakhs eighty six thousand five hundred only) was shown. We have mentioned this figure here because it will be relevant for the main controversy in this case.

It is the case of Prathapan that he continued to provide finance to the company by sending money to Ramanujam from time to time. The details of some of such disbursements are as under :

(a) A sum of Rs. 1,00,000 in March, 1989;

(b) US$ 6300 in favour of Maruthi Udyog Ltd. for allotment of a vehicle for the use of second appellant in November 1991;

(c) A sum of Rs. one lakh in February, 1994;

(d) A deposit of Rs. one lakh with State Bank of India in the year 1996

to provide bank guarantee in favour of the sales tax authorities at Kerala;

(e) A sum of Rs. Nine lakhs in January, 1996 for making remittance in favour of the Sales Tax Authorities.

According to Prathapan he was to be issued shares of the company against these remittances while according to Ramanujam the remittances were on personal account in view of the close relationship between the parties. The fact remains that the remittances were to Ramanujam and not to the company.

In the beginning, the business of the company was carried on by Ramanujam with the assistance of Muralidharan, brother of Prathapan who was acting as Manager of the Company, while Ramanujam was the Chairman and Managing Director of the company. It was not denied that Ramanujam was regularly getting salary for working as Managing Director of the company. According to Prathapan he was kept completely in the dark about the affairs of the company throughout. He never received a penny towards dividend on the shares held by him in the company.

Sometime in the year 1998 Prathapan is said to have come to India to consider acquiring another Hotel for expanding the business of the company. At that time he is said to have discovered certain startling facts about the company. The most important fact which is at the centre of the controversy in this case is that the company's authorised capital was increased from Rs. 15 lakhs to Rs. 25 lakhs and thereafter to Rs. 35 lakhs without the knowledge of Prathapan, a principal, shareholder of the company. Further in an alleged meeting of the Board of Directors of the company said to have been held on 24th October, 1994, chaired by Ramanujam, the Board of Directors of the company is said to have been informed about a sum of Rs. 6,86,500 (Rupees six lakhs eighty six thousand five hundred only) standing standing to the credit of Ramanuajum in the books of the company. He made a proposal for allotment of shares in lieu of that amount in his favour. As per the case of Ramanujam the Board allotted 6,865 equity shares of Rs. 100 each in the said meeting in his favour. According to Prathapan he was never made aware of the increase in authorised share capital of the Company and the alleged allotment of additional equity shares of the company in favour of Ramanujam. The alleged allotment reduces Prathapan, who was a majority shareholder in the company, to a minority shareholder in the company. Prathapan challenged this alleged allotment of shares in favour of Ramanujam by filing a Company Petition under Sections 397 and 398 of Companies Act before the Company Law Board in July, 1999. The main challenge in the Company Petition filed by Prathapan

alongwith his wife as co-petitioner, was to the said alleged allotment of 6865 equity shares of Rs. 100 each of the company. This was alleged to be an act of oppression on the part of Ramanujam who was managing the company. Prayer was made that the allotment of shares be set aside, and necessary correction be made in the Register of Members of the company. According to Prathapan Ramanujam did not contribute any money from his own resources for purposes of the company while all along he drew a handsome salary for working as the Managing Director. His maximum investment in the company could not be more than Rs. 20,000. He committed fraud and breach of trust as a result of which Prathapan and his wife had been totally marginalised in the company. In fact, Muralidharan, brother of Prathapan was removed from the Board of Directors of the company on 1st October, 1994 while Suresh Babu, brother-in-law of Prathapan and brother of Pushpa, (Prathapan's wife) was removed was Director on 30th September, 1996:

> Prathapan also alleged that Ramanujam siphoned off funds of the company for personal gains.
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> The Company Law Board took the view that Ramanujam had committed an act of oppression by not only not informing him about issue of further share capital of the Company but also not offering him the further share capital which was being issue by the company. Having given a finding of 'oppression' in favour of Prathapan the Company Law Board while considering relief, gave an option to Prathapan to sell his shares to Ramanujam. It was observed that a return of 12% per annum on the investment made by Prathapan would be fair in the facts of the case. Prathapan and his wife, who were petitioners in the company petition, were given liberty to sell their share to Ramanujam at par value with 12% simple interest per year from the date of their investment.
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> During the pendency of the company petition filed by Prathapan, a petition was filed before the Company Law Board for rectification of the Register of Members so as to delete the entires recording of transfer of shares in favour of Prathapan and his wife. This was on the ground that they had failed to obtain permission of the Reserve Bank of India under the Foreign Exchange Regulation Act regarding transfer of shares in their favour.
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> In the proceedings in the petition under Sections 397 and 398 of the Companies Act, locus standi of Prathapan and his wife to file the petition was challenged. This issue was decided by the Company Law Board against Ramanujam. The petition for rectification of Register of members was dismissed. However, Prathapan was aggrieved about the relief granted by the Company Law Board. Inspite of the finding on oppression being in his favour, he was asked to sell his shares and leave the company. Ramanujam was aggrieved of the finding of oppression against him and of the dismissal of the application for rectification of Register of Members. Both parties approached the High Court of Kerala against the judgment of the Company Law Board. The High Court maintained the judgment of the Company Law Board so far as the rejection of petition for rectification of Register of members was concerned.

However, the High Court allowed the appeal filed by Prathapan which was directed mainly on the question of relief granted by the Company Law Board. The High Court took a serious view of the manner in which Ramanujam was managing the affairs of the company. The High Court held it to be an act of fraud on the part of Ramanujam in allotting 6865 equity shares of the company in his favour. The High Court further held that a perpetrator of fraud could not be allowed to take benefit of his own wrong. The High Court found that the observation of the Company Law Board that the appellants can sell their share at par value to the Managing Director, getting 12% interest on their investment, will not be justified but will only help the manipulator. The High Court ordered setting aside of allotment of shares made in the Board Meetings held on 24th October, 1994 and 26 March, 1997, to Ramanujam, the Managing Director of the company. The Share Register was ordered to be rectified accordingly. The present appeal by Ramanujam is directed against the judgment of the High Court.

On the basis of the submissions made by the learned counsel for the parties, following issues arise for consideration.

Issue 1. Validity of allotment of equity shares of the Company in favour of Ramanujam whereby he becomes a majority shareholder and Prathapan and his wife are reduced to minority shareholders.

This issue gives rise to following questions :

(a) Was a meeting of the Board of Directors of the Company held on 24th October, 1994 when the first allotment of additional shares in favour of Ramanujam is said to have been made?

(b) Was it a valid meeting of the Board of Directors of the Company?

(c) Did the Company require funds so as to necessitate raising of share capital of the company by issuing further equity shares?

(d) Was the alleged allotment of equity shares in favour of Ramanujam a bonafide act on the part of Board of Directors in the interest of the Company? In other words does the act of raising share capital by allotment of additional equity shares in favour of Ramanujam, the Managing Director, amount to an act of oppression on his part towards the then majority shareholders?

Issue 2. What is the effect of not obtaining permission of the Reserve Bank of India under the Foreign Exchange Regulation Act (FERA) by Prathapan regarding transfer of shares in his and his wife's favour? Did Prathapan and his wife Pushpa have no locus standi to file the petition under Sections 397 and 398 of the Companies Act before the Company Law Board?

Issue 3. Scope of power of the High Court in an appeal under Section lOF of the Companies Act;

Issue 4. Relief to be granted to a majority shareholder who by an act of oppression on the part of management of the company is converted into a minority shareholder.

Issue 1. Validity of allotment of equity shares This is the main issue which arises for consideration in this case. As already noted Ramanujam who was the Managing Director of the company got allotted 6865 equity shares to himself in a meeting of the Board of Directors of the company alleged to have been held on 24th October, 1994. Again on 26th March, 1997 he managed to get allotted further 9800 equity share to himself. Prathapan has challenged these allotments of shares in favour of Ramanujam as acts of oppression on the part of Ramanujam, the Chairman and Managing Director of the company for which he filed a petition under Sections 397 and 398 of the Companies Act before the Company Law Board. A doubt has been cast about whether the alleged meetings in which additional equity shares were allotted to Ramanujam were held at all. In this behalf the following facts are noticeable :

> (a) The appellants have filed a photocopy of the minutes of the alleged meeting of the Board of Directors said to have taken place on 24th October, 1994. As per the photocopy the minutes appear to be signed by Ramanujam as Chairman. The presence of Suresh Babu as a Director of the Company has been shown in the minutes. However, there is no evidence of presence of Suresh Babu in the said meeting. Article 36 of the Articles of Association of the company requires that a notice convening the meetings of the Board of Directors shall be issued by the Chairman or by one of the Directors duly authorized by the Board in this behalf. Suresh Babu filed an affidavit in the proceedings before the Company Law Board wherein he has categorically stated that at no point of time he was involved in the affairs of the company and in running the business of the company. Further he has stated in the said affidavit that at no point of time he was informed that he had been appointed as Director of the company. He had never received any notice of any Board Meetings nor had he ever attended any Board meeting. In view of this categorical denial by Suresh Babu about attending any meetings of the Board of Directors of the company, it was incumbent on the part of Ramanujam who was the Chairman and Managing Director of the company and was in possession of all the records of the Company, to place 'on record copy of a notice calling a meeting of the Board of Directors in terms of Article
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> 36. No copy of the notice intimating Suresh Babu about the meeting of the Board of Directors and asking him to attend the same, has been placed on record to show that Suresh Babu was informed about holding of the meeting in question.

Here reference is required to be made to certain other Articles of the company which are relevant for the controversy. Article 8 provides that shares of the company shall be under the control of the Directors who may allot the same to such applicants as they think desirable of being admitted to membership of the company. Article 10 provides that allotment of shares "shall exclusively be vested

in the Board of Directors, who may in their absolute discretion allot such number of shares as they think proper..." Article 38 requires that the Directors present at the Board Meeting shall write their names and sign in a book specially kept for the purpose. Article 4(iii) prohibits any invitation to the public to subscribe for any shares or debentures of the company. The above provisions of the Articles of Association show that the Board of Directors have an absolute discretion in the matter of allotment of shares. But this pre-supposes that such a decision has to be taken by the Board of Directors. The decision is taken by the Board of Directors only in meetings of the Board and not elsewhere. Ramanujam, the Managing Director cannot take a decision on his own to allot shares to himself. If Suresh Babu was Present in the meeting, as is the case of Ramanujam, he must have signed a book specially kept for recording presence of the Directors at the Board Meeting in terms of Article 38. Ramanujam should have been the first person to produce such a book to show the presence of Suresh Babu at the alleged Board meeting said to have been held on 24th October, 1994 specially when Suresh Babu was denying his presence at the meeting. Nothing has been produced. Thus neither a copy of a notice convening the Board meeting nor the log book mean to record signatures of Directors attending the meeting of the Board of Directors were produced. In the absence of these documents and any other proof to show that a meeting was held as alleged we are unable to accept that a meeting of the Board of Directors was held on 24th October, 1994. If no meeting of the Board of Directors took place on that date, the question of allotment of shares to Ramanujam does not arise. We are inclined to believe that photocopy of the minutes of the alleged meeting dated 24th October, 1994 produced by appellants, is sham and fabricated. The alleged allotment of additional equity shares of the company in favour of Ramanujam is, therefore, wholly unauthorized and invalid and has to be set aside.

Normally this Court would not have gone into these questions of fact. However, the learned counsel for the appellant in the course of his arguments drew our attention to the various Articles of Association of the company, which unfortunately neither the Company Law Board nor the High Court considered. We cannot help referring to them, particularly in view of the fact that the Articles of a company are its constituent document and are binding on the company and its Directors.

The facts on record show that the company was being run as one man show and Ramanujam was maintaining the Minutes Book of meetings of Board of Directors only to comply with the statutory requirement in this behalf. The minutes were being recorded by him according to his choice and at his instance. The minutes do not reflect the actual position. Article 38 mandated that a book should be maintained to record presence of Directors at meetings of the Board of Directors. If a book for recording signatures of Directors attending meetings of the Board of Directors was not maintained, it was in clear violation of Article 38 of the Articles of Association of the company. The Company Law Board without going into these relevant aspects, proceeded on an assumption that a meeting of the Board of Directors did take place on 24th October, 1994. This assumption of the Company Law Board is clearly without any basis.

(b) When no meeting of the Board of Directors of the company was held on 24th October, 1994, the question of validity of the meeting does not arise. On the relevant date Suresh Babu was the only other Director of the company. He denies having attended any meeting of the Board of Directors of the company. There is nothing to rebut this stand of Suresh Babu. In his absence no valid meeting of

the Board of Directors could be held.

(c) For considering this point let us assume that a meeting of the Board of Directors of the company did take place as alleged by Ramanujam. First question that arises is whether the company required additional funds for which the shares were issued. We have already referred to Balance Sheets of the company, copies whereof have been placed on record. Till 31st March, 1993 the Balance Sheets did not show any investment of substantial amounts of money in the company. It is the Balance Sheet for the year ending 31st March, 1994 which for the first time shows an advance of Rs. 6,86,500 towards share capital pending allotment. Nothing has been placed on record to show that during the financial year 1993-94 i.e. 1st April, 1993 to 31st March, 1994 suddenly need had arisen for a substantial investment. The company was running a hotel, the property whereof was owned by the company. No particular reason for making a major investment has been shown. Nothing has been shown as to how the amount of Rs. 6,86,500 was utilised. It appears that Ramanujam who was managing the affairs of the company single handedly, realized that the company had turned around and the Hotel property had appreciated in terms of its market value. He started working on a strategy to get controlling shares in the company. It was in furtherance of this objective that Ramanujam managed to show the entry regarding advance against shares in the Balance Sheet as on 31st March 1994. For this amount, he allotted equity shares to himself to gain control of the company. In these facts it is difficult for us to appreciate that the additional funds were required by the company. In our view the finding of the High Court that no funds were needed by the company is fully justified. The only purpose was to allot additional shares in the company to himself to gain control of the company and to achieve this objective, the books of the company appear to have been manipulated. The High Court was right in holding that the entire manipulation of records of the company by Ramanujam was an act of fraud on his part.

(d) We may also test the alleged act of allotment of equity shares in favour of Ramanujam from a legal angle. Could it be said to be a bonafide act in the nterest of the Company on the part of Directors of the Company?

At this stage it may be appropriate to consider the legal position of Directors of companies registered under the Companies Act. A company is a juristic person and it acts though its Directors who are collectively referred to as the Board of Directors. An individual Director has no power to act on behalf of a company of which he is a Director unless by some resolution of the Board of Directors of the Company specific power is given to him/her. Whatever decisions are taken regarding running the affairs of the company, they are taken by the Board of Directors. The Directors of companies have been variously described as agents, trustees or representatives, but one thing is certain that the Directors. act on behalf of a company in a fiduciary capacity and their acts and deeds have to be exercised for the benefit of the company. They are agents of the company to the extent they have been authorized to perform certain acts on behalf of the company. In a limited sense they are also trustees for the shareholders of the company. To the extent the power of the Directors are delineated in the Memorandum and Articles of Association of the company, the Directors are bound to act accordingly. As agents of the company they must act within the scope of their authority and must disclose that they are acting on behalf of the company. The fiduciary capacity within which the Directors have to act enjoins upon them a duty to act on behalf of a company with utmost good faith,

utmost care and skill and due diligence and in the interest of the company they represent. They have a duty to make full and honest disclosure to the shareholders regarding all important matters relating to the company. It follows that in the matter of issue of additional shares, the directors owe a fiduciary duty to issue shares for a proper purpose. This duty is owed by them to the shareholders of the company. Therefore, even though Section 81 of the Companies Act which contains certain requirements in the matter of issue of further share capital by a company does not apply to private limited companies, the directors in a private limited company are expected to make a disclosure to the shareholders of such a company when further shares are being issued. This requirement flows their duty to act in good faith and make full disclosure to the shareholders regarding affairs of a company. The acts of directors in a private limited company are required to be tested on a much finer scale in order to rule out any misuse of power for personal gains or ulterior motives. Non-applicability of Section 81 of the Companies Act in case of private limited companies casts a heavier burden on its directors. Private limited companies are normally closely held i.e. the share capital is held within members of a family or within a close knit group of friends. This brings in considerations akin to those applied in cases of partnership where the partners owe a duty to act with utmost good faith towards each other. Non-applicability of Section 81 of the Act to private companies does not mean that the directors have absolute freedom in the matter of management of affairs of the company. In the present case Article 4 (iii) of the Articles of Association prohibits any invitation to the public for subscription of shares or debentures of the company. The intention from this appears to be that the share capital of the company remains within a close knit group. Therefore, if the directors fail to act in the manner prescribed above they can in the sense indicated by us earlier be held liable for breach of trust for misapplying funds of the company and for misappropriating its assets.

The learned counsel for the appellants argued that Articles of Association of the company give absolute power to the Board of Directors regarding issue of further share capital. The Board of Directors exercised the power while issuing further shares in favour of Ramanujam and the same cannot be challenged. In our view, this argument has no merit because the facts of the case do not support the argument. Firstly, the Articles of Association require such decisions regarding issue of further share capital to be taken in a meeting of the Board of Directors and we have found that the alleged meeting of the Board of Directors in which the additional shares are purported to have been issued in favour of Ramanujam was sham. Secondly, assuming for the sake of argument that meetings of Board of Directors did take place the manner in which the shares were issued in favour of Ramanujam wihtout informing other shareholders about it and without offering them to any other shareholder, the action was totally malafide and the sole object of Ramanujam in this was to gain control of the company by becoming a majority shareholder. This was clearly an act of oppression on the part of Ramanujam towards the other shareholder who has been reduced to a minority shareholder as a result of this act. Such allotments of shares have to be set aside.

On the role of Directors, the law is well settled. The position has been the subject matter of various decisions. Some of them are :

> In Regal (Hastings) Ltd. v. Gulliver and Others, (1942) l All ER 379 Lord Russel of Killowen observed as under :

> "Directors of a limited company are the creatures of a statute and occupy a position peculiar to themselves. In some respects they resemble trustees, in others they do not. In some respects they resemble agents, in others they do not. In some respects they resemble managing partners in others they do not. The said judgment quotes from Principles of Equity by lord Kames. In one sentence the entire concept is conveyed. The sentence runs "Equity prohibits a trustee from making any profit by his management, directly or indirectly. Ultimately the issue in each case will depend upon facts of that case".

Lindley MR observed in Alexander v. Automatic Telephone Co., (1900) 2 Ch. 56 at page 66-67 :

> "The Court of Chancery has always exacted from directors the observance of good faith towards their shareholders and towards those who take shares from the company and become co-adventurers with themselves and others who may join them. The maxim "Caveat emptor" has no application to such cases, and directors who so use their powers as to obtain benefits for themselves at the expense of the shareholders, without informing them of the fact, cannot retain those benefits and must account for them to the company, so that all the shareholders may participate in them."

M/s. Needle Industries (India) Ltd. and Others v. Needle Industries Newey (India) Holding Ltd. and Others, [1981] 3 SCC 333 is a judgment of this Court in which amongst vaious other aspects the power of directors regarding issue of additional share capital was also considered. This Court observed :

> "The power to issue shares is given primarily to enable capital to be raised when it is required for the purposes of the company but it can be used for other purposes also as, for example, to create a sufficient number of shareholders to enable the company to exercise statutory powers, or to enable it to comply with legal requirement as in the instant case. Hence if the shares are issued in the larger interest of the company, the decision cannot be struck down on the ground that it has incidentally benefited the Directors is their capacity as shareholders. So if the Directors succeed, also or incidentally, in maintaining their control over the company or in newly acquiring it, it does not amount to an abuse of their fiduciary power. What is objectionable is the use of such power simply or solely for the benefit of Directors or merely for an extraneous purpose like maintenance or acquisition of control over the affairs of the company. Where the Directors seek, by entering into an agreement to issue new shares, to prevent a majority shareholder from exercising control of the company, they will not be held to have failed in their fiduciary duty to the company if they act in good faith in what they believe, on reasonable grounds, to be the interests of the company. But if the power to issue shares is exercised from an improper motive, the issue is liable to be set aside and it is immaterial that the issue is made in a bonafide belief that it is in the interest of the company."

In the Needle Industries case (supra) the Board of Director had resolved to issue 16000 enquiry shares of Rs. 100 each to be offered as rights shares to the existing shareholders in proportion to the shares held by them. The offer was to be made by a notice specifying the number of shares to which each shareholder was entitled to. The notice further said, in case the offer was not accepted within 16 days from the date on which it was made, it was to be deemed to have been declined by the concerned shareholder. The Holding Company held 18990 shares and it was entitled to 9495 rights shares. The Holding Company could not avail its right to exercise the option for purchase of rights shares offered to it. As a result the whole of the Rights Issue consisting of 16000 shares was allotted to the Indian shareholders. The Holding Company filed a petition under Sections 397 and 398 of the Companies Act, 1956 in the High Court. The The Single Judge held in favour of the Holding Company that it had suffered a loss in view of the fact that the market value of the rights share was Rs. 190 whereas the shares were allotted at par i.e. at Rs. 100. The grievance of the Holding Company was that on account of postal delays it failed to receive the notice containing the offer of rights shares in time, and therefore, it could not exercise its option to buy the share. On appeal the Division Bench held that the affairs of Needle Industries India Ltd. were being conducted in a manner oppressive to the Holding Company. The Division Bench ordered winding up of the company. A further appeal to the Court was allowed mainly on the ground that there was no oppression. However, a direction was issued that the Indian shareholders pay an amount equivalent to that by which unjustifiably enriched, namely Rs. 90 x 9495 which comes to Rs. 8,54,550 to the Holding Company.

In the Needle Industries case (supra) this Court referred to some old English decisions with approval. Punt v. Symons, (1903) 2 Ch 506 was quoted in which it was held "where the shares had been issued by the Directors, not for the general benefit of the company, but for the purpose of controlling the holder of the greater number of shares by obtaining a majority of voting power, they ought to be restrained from holding the meeting at which the votes of the new shareholders were to have been used."

Piery v. S. Mills & Co. Ltd., (1920) l Ch. 77 applied the same principle while holding :

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

In Hogg v. Cramphorn Ltd., (1967) l Ch. 254, Buckley, J. reiterated the principle in Punt and in Piercy. It was held that if the power to issue shares was exercised for an improper motive the issue was liable to be set aside and it was immaterial that the issue was made in a bona fide belief that it was in the interests of the company.

The principle deduced from these cases is that when powers are used merely for an extraneous purpose like maintenance or acquisition of control over the affairs of the company, the same cannot be upheld.

Courts in the Commonwealth countries including England and Australia have emphasized that the duty of the Directors does not stop at "to act bonafide" requirement. They have evolved a doctrine called the 'proper purpose doctrine' regarding the duties of company directors. In Hogg v. Cramphorn, (supra), explicit recognition was given to the proper purpose test over and above the tribunal bonafide test. In this case the director had allotted shares with special voting rights to the trustees of a scheme set up for the benefit of company employees with the primary purpose of avoiding a takeover bid. Buckley, J. found as a fact that the directors had acted in subjective good faith. They had indeed honestly believed that their actions were in best interest of the company. Despite this it was observed :

> "an essential element of the scheme, and indeed its primary purpose, was to ensure control of the company by the directors and those whom they could confidently regard as their supporters."

As such, he concluded that the allotment was liable to be set aside as a consequence of the exercise of the power for an improper motive. He also held that the power to issue shares was fiduciary in nature. In Howard Smith Ltd. v. Ampol Petroleum Limited, (1974) AC 821, the Privy Council confirmed the above view expressed by Buckley, J. which shows a preference for the proper purpose doctrine. The Privy Council felt that the bonafide test was not sufficient to meet the challenge because it failed to encompass the obligation of directors to be fair. The directors' acts should not only satisfy the test of bonafides, they should also be done with a proper motive, Any lingering doubts over the status of the proper purpose doctrine as a separate and independent head of directors duty within the common law jurisdiction have been laid to rest by two decision of the Court of Appeal in England in Rolled Steel Products (Holdings) Limited v. British Steel Corporations, (1986) Ch. 246 and Bishopsgate Investment Management Ltd. (in liquidation) v. Maxwell (No. 2), [1994] l All ER 261. It was held by the Court of Appeal in Bishopsgate that the bonafides of the directors alone would not be determinative of the propriety of their actions. In a parallel development in Australia the proper purpose doctrine has been approved in a decision of the High Court in Whitehouse v. Carlto Hotel Pty. Ltd., (1987) 162 CLR 285.

The Tea Brokers (P) Ltd. and Others v. Hemendra Prosad Barooah, (1998) 5 Company Law Journal 463 was also a case of a minority shareholder who on becoming managing director of the company, issued further share capital in his favour in order to gain control of management of the company. Barooah and his friends and relations were majority shareholders of the respondent company having 67% of the total issued capital of the company. Barooah personally held 300 equity shares out of 1155 shares issued by the company. He was at all material times a director of the company. His case was that he was wrongfully an illegally ousted from the management of the company. One Khaund, who initially started as an employee of the company had 110 shares in the company and belonged to theminority goup. Khaund was appointed as the managing director of the company. Barooah's grievance was that Khaund took advantage of his position as managing director and acted in a manner detrimental and prejudicial to the interests of the company and in a manner conducive to his own interest. Khaund had hatched a plan with other directors to convert petitioner Barooah into a minority and to obtain full and exclusive control and management of the affairs of the company. In a petition filed under Sections 397 and 398 of the Companies Act, 1956, acts of Khaund

were found to be by way of 'oppression and mismanagement' within the meaning of Sections 397 and 398 of the Companies Act. Allotment of 100 equity shares by the company to Khaund at a meeting of the Board of Directors said to have been held on 14th January, 1971 was held to be illegal. The Board of Directors of the company was superseded and a special officer was appointed to carry on manage-ment of the company with the advice of Barooah, Khaund and a representative of labour union. There were several other directions issued by the court which are not necessary to be mentioned here. The Division Bench considered in detail the relevant legal position. Without using the phrase 'proper purpose doctrine' the principle enunciated therein, was applied. The following observations of Justice A.N. Sen are reproduced:

> "It is well settle that the directors may exercise their powers bona fide and in the interest of the company. If the directors exercise their powers of allotment of shares bona fide and in the interest of the company, the said exercise of powers must be held to be proper and valid and the said exercise of powers may not be questioned and will not be invalidated merely because they have any subsidiary additional motive even though this be to promote their advantage. An exercise of power by the directors in the matter of allotment of shares, if made mala fide and in their own interest and not in the interest of the company, will be invalid even though the allotment may result incidentally in some benefit to the company."

Further it was held that if a member who holds the majority of shares in a company is reduced to the position of minority shareholder in the company by an act of the company or by its Board of Directors malafide, the said act must ordinarily be considered to be an act of oppression to the said member. The member who holds the majority of shares in the company is entitled by virtue of his majority to control, manage and run and affairs of the company. This is a benefit or advantage which the member enjoys and is entitled to enjoy in accordance with the provisions of company law in the matter of administration of the affairs of the company by electing his own men to the Board of Directors of the company.

On the question of relief, the court observed :

> "A majority shareholder should not ordinarily be directed to sell his shares to the minority group of shareholders, if per chance through fortuitous circumstances or otherwise, the minority group of shareholders come into power and management of the company. The majority shareholders by virtue of their majority will usually be in a position to redress all wrongs done and to undo the mischief done by the minority group of shareholders, as it will always be possible for the majority group of shareholders to regain control of the company so long as they remain in majority in the company by virtue of the majority. Except in unusual circumstances, the majority group of shareholders, in my opinion, should never be ordered or directed to sell their shares to the minority group of shareholders. An orders directing the majority group of shareholders to sell his shares to the minority group of shareholders will not redress the wrong done to the majority group of shareholders and will not give him sufficient compensation or relief against the act of oppression complained of by him,

> and, on the other hand, may add to his suffering and grievance and cause him greater hardship. Such an order will not further the ends of justice and indeed the cause of justice may be defeated."

On the question of issue of fresh share capital, it was held to be illegal to issue shares to only one shareholder. This was held to be a violation of common law right of every shareholder. Common Law recognized a pre-emptive right of a shareholder to participate in further issue of shares however. In India in view of Section 81 of the Companies Act, such a right cannot be found for sure. However, the test to be applied in such cases which requires the court to examine as to whether the shares were issued bonafide and for the benefit of the company, would import such considerations in case of private limited companies under the Indian Law. Existence of right to issue shares to one director may technically be there, but the question whether the right has been exercised bonafide and in the interests of the company has to be considered in facts of each case and if it is found that it is not so, such allotment is liable to be set aside.

Reference has been made to the case of Piercy v. S. Mills & Co. Ltd., (1920) l Ch 77 (Ch.D) where directors, who controlled merely a minority of the voting power in the company allotted shares to themselves and their friends not for the general benefit of the company, but merely with the intention of thereby acquiring a majority of the voting power and of thus being able to defeat the wishes of the existing minority of shareholder, it was held that, even assuming that the directors were right in considering that the majority's wishes were not in the best interests of the company, the allotments were invalid and ought to be declared void. It follows from this case that the exercise by directors of fiduciary powers for purposes other than those for which they were conferred is invalid. It may be said that although the power of issuing shares is given to directors primarily for the purpose of enabling them to raise capital when required for the purpose of the company, this was not the object of the directors in this case..."

It will be seen from the judgments in Needle Industries (supra) and Tea Brokers (supra) that the courts in India have applied the same tests while testing exercise of powers by directors of companies as in other Commonwealth countries.

In the present case we are concerned with the propriety of issue of additional share capital by the Managing Director in his own favour. The facts of the case do not pose any difficulty particularly for the reason that the Managing Director has neither placed on record anything to justify issue of further share capital nor it has been shown that proper procedure was followed in allotting the additional share capital. Conclusion is inevitable that neither the allotment of additional shares in favour of Ramanujam was bonafide nor it was in the interest of the company nor a proper and legal procedure was followed to make the allotment. The motive for the allotment was malafide, the only motive being to gain control of the company. Therefore, in our view, the entire allotment of shares to Ramanujam has to be set aside.

Even the Company Law Board found that the allotment of additional shares by Ramanujam to himself was an act of oppression on his part. The Company Law Board drew this conclusion solely for the reason that no offer had been made to the majority shareholders regarding issue of further

share capital. The High Court accepted the finding of oppression. However, it placed it on a much broader base by taking into consideration various other factors. The High Court's finding is based on a much stronger footing. In fact, the High Court has gone on to conclude that Ramanujam has played a fraud on the minority shareholders by manipulating the allotment of shares in his favour. We find no reason to differ with the finding of the High Court.

Issue 2 :

> This brings us to the issue regarding locus standi of Prathapan and Prathapan's family to maintain the petition under Sections 397 and 398 of the Companies Act and their failure to obtain permission of the Reserve Bank of India as per Section 29 of the Foreign Exchange Regulation Act. So far as the question of permission of the Reserve Bank of India under FERA is concerned the same can be obtained ex-post facto. This stands concluded by judgment of this Court in Life Insurance Corporation of India v. Escorts, [1986] l SCC 264. The statute does not provide any time limit for obtaining the permission. We cannot lose sight of the subsequent development in this connection. FERA stands repealed and the statute brought in force by way of replacement of FERA, i.e. the Foreign Exchange Management Act (FEMA), does not contain any such requirement.
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> On the question of locus standi the learned counsel for the respondent cited Rajahmundry Electric Supply Corporation Ltd. v. A. Nageshwara Rao and Others, AIR (1956) 213, wherein it was held that the validity of a petition must be judged from the facts as they were at the time to its presentation, and a petition which was valid when presented cannot cease to be maintainable by reason of events subsequent to its presentation. In 5. Varadarajan v. Venkateshwara Solvent Extraction (P) Ltd. and Others, (1994) 80 Company Cases 693, a petition was filed by the applicant and four others under Sections 397 and 398 of the Companies Act. During the pendency of the petition, the four other persons who had joined the applicant in filing the petition sold their share thereby ceasing to be shareholders of the company. It was held that the application could not be rejected as not maintainable on the ground that the four shareholders ceased to be shareholders of the company. The requirement about qualification shares is relevant only at the time of institution of proceeding. In Jawahar Singh Bikram Singh v. Sharda Talwar, (1974) 44 Company Cases 552, a Division Bench of the Delhi High Court held that for the purposes of petition under Sections 397/398 it was only necessary that members who were already constructively before the court should continue the proceedings. It is a case in which the petitioner who had filed a petition died during the pendency of the petition. While filing the petition he had obtained consent of requisite number of shareholders of the company, among them his wife was also there. The Court further observed that since wife of the petitioner was already constructively a petitioner in the original proceedings, by virtue of her having given a consent in writing, she was entitled to be transposed as petitioner in place of her husband.

It is to be further noted that the entire scheme regarding purchase of shares in the name of mother of Prathapan was suggested by Ramanujam himself. He was to it that the shares were transferred by the company in the name of Prathapan and his wife. The company has recorded the transfer and corrected its Register of Members in this behalf which, in fact, led Ramanujam to file a petition for rectif cation of the Register of Members as a counterblast to the petition filed by Prathapan under Sections 397/398 of the Companies Act. It is not open to Ramanujam now to raise the question of FERA Violation, more particularly in view of his having recorded the transfer of shares in the name of Prathapan and his wife Pushpa in the records of the Company. This also answers the objection regarding locus standi of Prathapan and his wife to file the Sections 397/398 petition before the Company Law Board. Since they were registered as shareholders of the company on the date of filing of the petition and they held the requisite number of shares in the company, they could maintain the petition.

We, therefore, find no merit in the contention that the petition under Sections 397/398 of the Companies Act, filed by the Prathapan and his wife before the Company Law Board was not maintainable.

Issue 3 :

Scope of power of High Court in appeal under Section 10F of the Companies Act.

We have now to deal with the question of scope of appeal filed under Section l 0F of the Companies Act by Prathapan in the High Court Section l OF refers to an appeal being filed on the question of law. The learned counsel for the appellant argued that the High Court could not disturb the findings of facts arrived at by the Company Law Board. It was further argued that the High Court has recorded its own finding on certain issues which the High Court could not go into and therefore the judgment of the High Court is liable to be set aside. We do not agree with the submission made by the learned counsel for appellants. it is settled law that if a finding of fact is perverse and is based on no evidence, it can be set aside in appeal even though the appeal is permissible only on the question of law. The perversity of the finding itself becomes a question of law. In the present case we have demonstrated that the judgment of the Company Law Board was given in a very cursory and cavalier manner. The Board has not gone into real issues which were germane for the decision of the controversy involved in the case. The High Court has rightly gone into the depth of the matter. As already stated the controversy in the case revolved around alleged allotment of additional shares in favour of Ramanujan and whether the allotment of additional shares was an act of oppression on his part. On the issue of oppression the finding of the Company Law Board was in favour of Prathapan i.e. his impugned act was held to be an act of oppression. The said finding has been maintained by the High Court although it has given stronger reasons for the same.

We find no merit in the argument that the High Court exceeded its jurisdiction under Section 10F of the Companies Act while deciding the appeal.

Issue 4 : Relief On the question of relief, the learned counsel for the parties referred to decisions in support of their respective stands. We do not consider it necessary to refer to these decisions because relief depends on facts of a particular case. We have seen the facts of the present case which to our mind are so manifestly against Ramanujam that two opinions are not possible on the aspect of relief. The only relief that has to be granted in the present case is to undo the advantage gained by Ramanujam though his manipulations and fraud. The allotment of all the additional shares in favour of Ramanujam has to be set aside. In our view, the High Court was fully justif ed in granting the relief of setting aside the impugned allotments to additional shares in favour of Ramanujam. The approach of the Company Law Board was totally erroneous in as much as after having found that there was oppression on the part of Ramanujam, he was still allowed to take advantage of his own wrong in as much as he was given the option to buy Prathapan's shares and that too not for a proper price. In our view the Company Law Board was wrong in allowing purchase of shares of Prathapan and his wife by Ramanujam. Such an order amounts to rewarding the wrong doer and penalizing the oppressed party. In the circumstances of this case asking the oppressed to sell his shares to the oppressor not only fails to redress the wrong done to the oppressed, it also results in heavy monetary loss to him. The relief granted by the High Court was a proper relief in the facts of the case.

All the appeals are accordingly dismissed with costs. Counsel fee Rs. 50,000.