CHAPTER VII

INVESTIGATION, AMALGAMATION AND DOCTRINE OF DISCLOSURE (SECTION 235 to 251):

INVESTIGATION

1. INVESTIGATION IN GENERAL:

The term investigation means 'a formal or official examination or study, as by the Police or a Governmental agency'. The usual object of investigation is to bring to surface facts and make them known to the person concerned. It may be an individual or Governmental agency or a body corporate.

Need For Investigation:

It may be submitted that need for investigation into the affairs of a company or a body corporate may arise due to various reasons, the most important of them being the protection of public interest; i.e. the interest of investors and also the creditors and also the general public.

In the case of Barium Chemical Ltd. v. the Company Law Board, Mudholkar J. recognising the importance of investigation observed:

"There is no doubt that few shareholders have the means or ability to act against the management. It would further more difficult for the shareholders to find out the facts leading to the poor financial condition of a company. The
Government thought it right to take power to step in, where there was reason to suspect that the management may not have been acting in the interest of the shareholders, and to take steps for the protection of such investors. So it may be stated that the object of investigation under the provisions of Companies Act, is to protect the interests of investors, who have become mere investors of fund, without having any desire or ability to take any active part in the affairs of the company. The reasons for shareholders inactivity are:

(a) They are normally investors and are interested, only in the dividend they get. So long, they keep on getting satisfactory dividends they are not bothered about the other affairs of the company, i.e. its management and control etc.

(b) The shareholders are widely spread over and are not in a position to organise themselves. The reason for this may be either they are too many and their holdings are small or they are indifferent to their statutory rights, e.g. voting and controlling the affairs of the company.

(c) They are ill-equipped to challenge the wisdom and experience of the persons who really control the affairs of the company. i.e. its directors and other managerial personnel.
(d) They are being unorganised, they normally do not have the means or ability to act against the management.

(e) Lastly, the doctrine or Ultra Vires is no longer a significant check on corporate spending.

THE SCHEME UNDER THE ACT:

It has always been the intention of Company Law to prevent the exploitation of innocent members and creditors and general public by dishonest and unscrupulous management particularly directors. With this object, the Legislature has provided for investigation into the affairs of the Company and for this purpose very wide powers have been given to the Central Government.

Sections 235 to 251 deals with the subject of investigation of the affairs of the company. So far these provisions are concerned, they are based on Sections 164 to 175 of the English Companies Act, 1948 except few changes.

The Powers of the Central Government:

The powers conferred on the Central Government for ordering investigation under the Act are discretionary, while those conferred by Section 237(a) are obligatory. It may be submitted that in exercising the discretionary
powers the Central Government is required to ensure that a substantial and worthwhile basis exists, for ordering investigation. For example, where the allegations are more of a recriminatory nature arising out of a factional fights between two or more groups of members, the Government will not ordinarily lend itself to be a party to such dispute. Further, if remedies to any situation or general contraventions of the provisions of Law can be found elsewhere, ordering of investigation will be unnecessary.

Objectives which may form the pre-requisite for the ordering of effective investigation are:

(a) Whether an inspector can bring to light any major contravention of the provisions of companies Act, or any other law on the basis of which necessary corrective remedial measures can be applied.

(b) Whether the application of such measures alone will be enough to lend succour to the aggrieved parties, where necessary or to set right the affairs of companies, so as to bring them in conformity with the accepted principles and standard of good and efficient management; and

(c) Whether the allegations bring out clearly or by implication, a charge of irregular accounting, the
truth of which can be established only by the analysis of the books by a qualified Chartered Accountant.²

Scope of Power:

In Rohtas Industries Ltd., v. V.S.D. Aggarval³ Hegde J. observed:

The power under section 235 to 237 has been conferred on the Central Government on the faith that it will be exercised in a reasonable manner. The department of the Central Government which deals with companies is presumed to be an expert body in company law matters. Therefore, the standard that is prescribed under section 237(b) is not the standard required of an ordinary citizen but that of an expert. The learned Attorney did not dispute the position that if we come to the conclusion that no reasonable authority would have passed the impugned order on the material before it, then the same is liable to be struck down... The law recognises certain well recognised principles within which the discretionary power under section 237(b) must be exercised. There must be real exercise of the discretion. The authority must be exercised honestly and not for corrupt or ulterior purposes. The authority must form the requisite opinion honestly and after applying its mind to the relevant materials before it. In exercising the discretion the authority must have regard only to
circumstances suggested one or more of the matters specified in clauses (i), (ii) and (iii). It must act reasonably and not capriciously or arbitrarily. It will be an absurd exercise of discretion, if for example the authority form the requisite opinion on the ground that the director in charge of the company is a member of a particular community. Within this narrow limits the opinion is not conclusive and can be challenged in a Court of law. Had Section 237(b) made the opinion conclusive, it might be open to challenge as violative of Articles 14 and 19 of the Constitution. Section 237 (b) is not violative of Articles 14 and 19 of the Constitution.\(^4\)

If it is established that there were no materials upon which the authority could form the requisite opinion the Court may infer that the authority did not apply its mind to the relevant facts. The requisite opinion is then lacking and the condition precedent to the exercise of the power under section 237(b) is not fulfilled.

In an English case,\(^5\) the English Court observed that "investigation into the affairs of the company means an investigation of all its business affairs, profits and losses, assets including goodwill, contracts and transaction, investments and other property interests, its management and also the affairs of its subsidiaries."
So it may be stated that power conferred on the Central Government is very wide power but at the same time it is discretionary power and therefore, it must be used with due care and only when reasonable ground exist for ordering investigation. Further, it is challengable in the court of law, and as such, final say in the matter of investigation under Section 237(b) rest with the Court.

Grounds for the Order:

As per the provisions of the Act, an investigation may be ordered by the Central Government:

(i) On the application of members.

(ii) On the report of Registrar under Sub-sections (6) & (7) of Section 234.

(iii) On a special resolution by the company, for investigation (section 237(a)(i)).

(iv) On an order of Court for investigation (section 237(a)(ii))

(v) On its own opinion formed under section 237(b).

(I) Investigation on Request (Section 235):

According to section 235, which is analogous to section 164 of the English Companies Act, 1948 and Section 138 of the Previous Companies Act, Central Government may,
at any time, order for an investigation into the affairs of the company, on an application by members as prescribed under clauses (a) & (b) of the section.

It may be mentioned that the term 'member' is not qualified and therefore, it means any member whether holding equity share capital or preference share capital, may apply under section 235.

As per the provisions, an application must be supported by such evidence as the Central Government may require for the purpose of showing that the applicants have good reason for requiring the investigation, and it may, before appointing inspector, require the applicants to give security not exceeding Rs.1,000 for payment of cost of investigation. Further the applicants are also required to comply with Rule 8 of the Central Government General Rules. According to this rule, certain disclosures are required to be made by the applicants. They are:

(1) Every application shall specify:

(a) the names and addresses of the applicants;
(b) if the company has a share capital, the voting power held by each applicant;
(c) the total number of applicants;
(d) their total voting power; and
(e) the reasons for requiring the investigation.

(2) The reasons given in pursuance of clause (c) of sub rule (1) shall be specific and precise.

(3) Every such application shall be accompanied by such documentary evidence in support of the statements made therein as are reasonably open to the applicants, and every such application shall be signed by the applicants and shall be verified by their affidavit.

(4) The Central Government may, before passing orders on the application, may ask for further documentary or other evidence.

(i) for the purpose of satisfying itself as to the truth of the allegations made in the application; or

(ii) for ascertaining any information which, in the opinion of the Central Government, is necessary for the purpose of enabling it to press orders on the application.

So far as this section is concerned, it may be submitted that the power of the Central Government is discretionary. The use of the word 'may' in this section suggest that the Government is not obliged to direct an investigation or to appoint Inspectors for the purpose of investigation.
As per the existing provisions the power rests with the Central Government. The Sacher Committee has recommended that the "power under section 235 and 236 should be exercised by the company Law Board, and the Central Government should appoint inspectors to investigate only after the Company Law Board orders investigation. The object of this recommendation seems to have a preliminary inquiry conducted by the Company Law Board.

(II) Investigation on a Report by the Registrar of Companies:

In the case of any company:

(a) if the information required by the Registrar to be furnished in connection with any document submitted to him, is not furnished within time or if the document in question disclosed an unsatisfactory state of affairs or that it does not disclose a full and fair statement of the matters in which it purports to relate; and

(b) if it is represented to him that (i) the business of the company is being carried on in fraud of its creditors or persons dealing with the company, or (ii) other fraudulent or unlawful purpose, on a report by the Registrar, the Central Government may appoint one or more inspectors to investigate the affairs of the company and report thereon to the Central Government.
So far these provisions are concerned, it may be submitted that the expression 'unsatisfactory state of affairs' used under subsection (6) of Section 234 is very elastic and may include anything illegal, irregular or improper in respect of the affairs of the company prejudicially affecting the company, its shareholders or any of them or any creditors or public interest, and as such it gives very wide choice to the Registrar. Further, wording 'any other person interested' in subsection (7) suggest that only a person interested can make representation to the Registrar, and not any stranger; for instance, a rival company, or its directors or members as such cannot be said to have any interest.

(III) Investigation of Company's Affairs in other cases:

Apart from the provision in section 235 and without prejudice to its powers thereunder, section 237 makes it obligatory for the Central Government to appoint inspector in two cases. They are:

(1) When the company itself express it desire for investigation by passing a special resolution; or

(2) When the Court directs the Government to investigate the affairs of the company.
So far as this provision is concerned, two points require to be noted. Firstly, no condition has been laid down for the Court to make such an order; and secondly, there is no guideline as to who can seek the order of the Court under section 237(a)(ii).

So far as former is concerned, it was held that although, no condition has been laid for the court to make such an order, yet the Court may in its wisdom expect prima facie proof of some of these conditions. 7

Power of the Court under Section 237(a)(ii):

It may be mentioned that the section 237 conceives of three situations where the Central Government is required to appoint inspector for investigation.

The first is when the company itself declares by resolution that such an investigation is necessary.

The second is when the Court makes an order under section 237(a)(ii); and the third is, when the Central Government forms an opinion that circumstances enumerated in clause (b) exist.

So far as these situations are concerned, the first is easy to understand. When the company itself wants an investigation, the Central Government need not stop to enquire why. In case of third, it can be understood,
because when suo motto action is proposed to be taken by the Government and that action is likely to have an adverse effect, if it shall not act arbitrarily but only in accordance with the guidelines laid down. However, the second situation requires special attention.

In the case of P. Sreenivasan v. Yousuf Sagar Abdula and Sons (P) Ltd., it was argued on behalf of the petitioner 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. M.P. Memon J. observed 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, 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 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 requires relaxation in the interest of the company. The Calcutta High Court has held in Re Patraktu Tea Co. Ltd.,¹⁰ 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 minority acts in the interest of the company as a whole.
Yet in another case, it was held that in proceeding under section 237(a)(ii), the Court need not satisfy itself that the allegations were true but that those allegations have prima facie bearing on the fiduciary obligations of the majority to abide by the law. As remedy is equitable, the Court has also to satisfy itself that the petitioner has come to Court bonafide. An isolated instance of mismanagement already remedied may not justify the passing of an order under section 237(a)(ii).

In N.K.R.K. Amritharaj v. V.P.S.N. Ramish Nadar admitting the limitation on the power of the Court, it was held that after the Court directs that affairs of the company be investigated, the matter goes out of the jurisdiction of the court, and cannot go into inspector's report. It is then only the Central Government who can take further proceedings in the matter.

There is nothing in the language of section 237(a)(ii), indicating that a petition simpliciter for action under the section cannot be entertained, and that the power conferred by the section can only be exercised by the Court against a company, in respect of which some other proceedings is pending in the Court and the Court considers it proper to direct appointment of an inspector.
In a recent case, while holding that no case for issue of direction under section 237(a)(ii) is made out, the Court observed that 'where an application is made to the Court to appoint inspector to investigate the affairs of the company, the Court will not act on mere allegations. It can act only on material placed before it, and those material should at least be such as to satisfy the Court that a deeper probe into the Company's affairs is desirable in the interest of the company itself. No investigation can be ordered merely because a shareholder feels aggrieved about the manner in which the company's business is being carried on.'

Who can Apply:

As mentioned earlier there is no guideline as to who can seek the order of the Court under section 237(a)(ii). The Delhi High Court had to face this problem in the case of V.V. Purie v. F.N. C. Steel Ltd. The fact of the case was a dispute between the company and the landlord and the latter petitioned for an order or investigation into the affairs of the former. The grounds stated in the petition were that the company had taken loan and overdrafts from its bankers out of proportion to its capital as well as other resources.
It had diverted its funds, that one of the directors had developed political contacts and by virtue of association with person in power abused his influence in business matter, that the accounts and the auditor's report disclosed a state of affairs which called for investigation, and that one of the directors had misappropriated a sum of money belonging to the company. The petitioner was neither a shareholder nor had any other interest in the affairs of the company. Rather he had an interest adverse to the company. Having compelled the company to vacate his premises prematurely, he had to face its demand for refund of rent paid in advance. The Court considered the previous authorities on the question as to whether a stranger should be permitted to seek an order of investigation and found suitable guidance in the following statement of Kapur J. in Re Delhi Floor Mills Ltd. 16

It is open to any petitioner to move the Court for an order of investigation against a company. He need not be shareholder, he need not have any personal interest, he may be complete stranger and yet he can move the Court... If the Court has to deal with such petitions, the Court may be literally flooded with them. It is therefore, necessary for the Court, to act most cautiously on the question whether the affairs of the company need an investigation.
Rangnathan J. accepted the principle of caution and tried to rest it on a sounder basis. In this view there must be an infringement of a legal right before a remedy can be sought from a Court. Thus he stated: "The Court are intended to provide redress to litigants who complain of the infringement of their legal rights, and, in the absence of very clear words in a statute, it may not be construed as conferring on any person a right to move a Court when no legal injury has been caused to him. The legal maxim 'Ubi Jus Ibi Remedium' has two facets. It signifies in the first place, that whenever the law gives a right or prohibits an injury, the person who is injured or whose right is infringed will have a remedy of action in the Court. The converse of this proposition is equally true, viz. that there is no remedy by way of legal action unless there is the infringement of a legal right or where a person has no legal interest, he has no grievance in the eyes of law and he cannot seek intervention of the Court".

It was pointed out to the learned judge that one of the purposes of the provisions relating to investigation is the protection of public interest also, and, therefore, the provisions should not be confined to cases of personal injury. Expressing disagreement with this, he observed:
On general principles, it would not be correct to read the section as authorising any man in the street to seek order for investigation into the affairs of the company, merely because it is a public company and its affairs are, in his opinion, being conducted to the detriment of public interest. The interest which a person may have as a member of the public in the purity of the administration of public companies is far remote and intangible...

The Court cited extensively passages from the speeches delivered in the House of Lords in Gansiet v. Attorney General, and said:

The above extracts contain an enunciation of the general principle that the Court will not entertain action on behalf of private persons to enforce the observance of public rights and duties and unless their rights and interests are in some way affected. I think that even in the interpretation of section 237 this basic limitation should be treated as implicit and the section should not be given an interpretation which would make it possible for person to start litigation in respect of what does not concern them. The section should be so interpreted as to enable relief to be obtained only by some person whose rights have been affected by the manner in which the affairs of the company have been
conducted or accounts maintained and has, therefore, a grievance in the eye of law for which he seeks relief from the Court. There is ample scope for the invocation of Section 237 by persons whose rights are infringed or affected and whose interests need to be protected or safeguarded by an investigation—a creditor who is unable to move the Central Government under section 235, member or members who though aggrieved are unwilling to move the Central Government or unable to move the Central Government, member who approach the Central Government under sections 235 and 237(b) and are aggrieved by the rejections of their application, a company wants an investigation but is unable to have a special resolution passed. These are illustrations of persons who would be able to move the Court under section 237(a).

It may be submitted that his decision is undoubtedly on the facts of the case, but the theoretical justification offered for it seems to go much beyond the need of the occasion. The analogy of Ubi Jus Ibi Remedium seems to be out of place. This maxim is concerned with personal wrong and cannot be used to hinder the power of the Court for setting right the functioning of public institutions. One can have one's personal wrongs judicially remedied even in the absence of a Companies Act. The provisions of such wide amplitude as section 237 is,
became necessary for safeguarding such public matters in which private personal interests may be involved. The remark of the learned judge that anybody asking for investigation in the interest of purity of administration of public institutes is seeking the protection of a too remote and intangible interest, also proceeds on the hypothesis of indentifying, the machinery of investigation with rectification of matters causing personal grievances. The fact, however, is that the institution of investigation did not come into being for nor should it be confined to redressing personal grievances.

(IV) & (V) **Power of the Central Government (Section 237(b))**

Grounds for the Order - Statutory Discretion and Judicial Control:

Under clause (b) of section 237 the Central Government or company Law Board, may take the initiative suo moto or on the application of or information supplied by any shareholder or other person. In other words it empowers the Central Government or Company Law Board to interfere in the working of a company. Most companies are producing goods and services for the country. Unwarranted state interference into such centre of production may have crippling effect. Therefore, the power of the state has been regulated by certain principles listed in
the provisions itself. The stress of these provisions is that the management should be prevented from going against public or shareholders interest. It has been held by the Supreme Court in various cases and the Court can set aside an order of investigation if the facts revealed in the order cannot make out the grounds stated in the section.

As Shelat J. (S.C.) observed in Barium Chemical Ltd. v. Company Law Board, 18 "there must exist circumstances which in the opinion of the authority, suggest what has been set out in sub-clause (i), (ii) and (iii). If it is shown that the circumstances do not exist or that they are such that it is impossible for any one to form any opinion therefore, suggestive of the aforesaid things, the opinion is challengeable, on the ground of non-application of mind or perversity or on the ground that it was formed on collateral grounds and was beyond the scope of the statute."

In the same case Hidayathulla J. observed:
"An action not based on circumstances suggesting an inference of the enumerated kind will not be varied. In other words, the enumeration of the inferences which may be drawn from the circumstances, postulates the absence of a general discretion to go on fishing expedition to find evidence. No doubt the formation of opinion is
subjective but the existence of circumstances relevant to the inference as the *sine qua non* for action must be demonstrable. If the action is questioned on the ground that no circumstances leading to an inference of the kind contemplated by the section exists, the action might be exposed to inference unless the existence of the circumstances made out. Since the existence of circumstances is a condition fundamental to the making of an opinion, the existence of the circumstances, if questioned, has to be proved at least *prima facie*. It is not sufficient to assert that the circumstances exist and give no clue as to what they are because the circumstances must be such as to lead to conclusions of certain definiteness. The conclusions must relate to an intent to defraud, a fraudulent or unlawful purpose, fraud or misconduct or the withholding of information of a particular kind. We have to see whether the Chairman in his affidavit has shown the circumstances leading to such tentative conclusions. If he has, his action cannot be questioned because the inference is to be drawn subjectively and even if this Court would not have drawn a similar inference of the kind stated in section 237(b) can at all be drawn, that action would be *ultra vires* the Act and void"
In another case, it was held that "coming back to section 237(b) in finding out its true scope we have to bear in mind that, that section is a part of the scheme ... and, therefore, the said provisions takes its colour from sections 235 and 236. In finding out the legislative intent we cannot ignore the requirements of these sections. In interpreting section 237(b) we cannot ignore the adverse effect of investigation on the company. Finally we must also remember that the section in question is an inroad on the power of the company to carry on its trade or business and thereby an infraction of the fundamental right guaranteed to its shareholder under Article 19(1)(g) and its validity cannot be upheld unless it is considered that the power in question is a reasonable restriction in the interest of general public. In fact, the vires of that provision was upheld by a majority of the Judges constituting the bench in Barium Chemicals case, principally on the ground that the power conferred on the Central Government is not an arbitrary power and same has to be exercised in accordance with the restraints imposed by law. We agree with the conclusion reached by Hidayathulla and Shelat J. in Barium Chemicals case that the existence of circumstances suggesting that the company's business was being conducted
as laid down in sub-clause (i) or the person mentioned in sub-clause (ii) were guilty of fraud or misfeasance or other misconduct towards the company or towards any of its member is a condition precedent for the Government to form the required opinion and if the existence of those conditions is challenged the Courts are entitled to examine whether those circumstances were existing when the order was made. In other words the existence of the circumstances in question are open to judicial review though the opinion formed by the Government is not amenable to review by the Court. As held earlier the required circumstances did not exist in this case”.

Discussing the above cases Kapur J. of Delhi High Court helds as follow &

"there are three ways in which the power under section 237 can be invoked. The company may pass a special resolution to that effect, the Court may order the same. In such cases there is no restriction to the power being exercised, but in the case of Central Government, the power is circumscribed by section 237(b) which shows that the Central Government can order the investigation only if there are circumstances suggesting either that business of the company was being conducted with intent to defraud its creditors, members or any other persons or otherwise for unlawful purposes etc."
It is also held that there must be some kind of facts objectively existing which shows that an offence mentioned under section 237(b) has taken place. This section is not intended to deal with a roaring and finishing inquiry with a view to establishing that there has been fraud or misconduct or misfeasance. The offence must be there, and then investigation can take place. An investigation for finding out whether there has been offence means that the investigation is made in the circumstances which do not justify it, order of the Company Law Board was quashed.²⁰

In Barium Chemicals case also it was observed that "misconduct results from an act of conduct in the nature of a breach of trust or an act resulting in loss to the company. Misconduct of promoters or directors as understood in the companies Act means not misconduct of every kind but such as has produced pecuniary loss to the company by misapplication of its assets or other act".

In one English case it was held that if a company carry on business and incur debts at a time when there is to the knowledge of the directors, no reasonable prospect of the creditors ever receiving payment of those debts, it is in general a proper inference that the company is carrying on business with intent to defraud.²¹
In the case of Ashoke Marketing Ltd. v. Union of India, an order of investigation was challenged through writ petition. The affidavit of the State revealed that the company was at the helm of a group of companies and it was a common tendency of the shareholders of a block to benefit one another at the cost of the other shareholders. By way of instance, it was shown that the company had granted certain loans and had purchased low yield debentures. No fraud was shown to be involved in those transactions. It was held by the Delhi High Court that 'the order of investigation could not stand the judicial scrutiny'.

So it may be submitted that the power of the Central Government under section 237(b) is not an arbitrary power and same has to be exercised in accordance with the restraints imposed by the Act. Further, they also shows the existence of the circumstances in question, are open to judicial review, in other words statutory discretion is subject to judicial control. This is necessary as the power of the Central Government interferes with the right of a company to carry on its normal business, and investigation is likely to give bad name to the company.
Further it may be submitted that the English Judges has not taken serious view of the ordering of an investigation as the Indian Courts, particularly Supreme Court.

**Right to be Heard**

So far as section 237 is concerned, an important question arise as to whether, a company should be given an opportunity to be heard, before the opinion is formed for setting up the investigation. The judicial pronouncements in this regards are:

In an English case, the Court of Appeal gives cogent reasoning for holding that neither the provisions of the Act, nor the rules of natural justice requires that the company shall be given opportunity to be heard, before the opinion is formed for setting up the investigation. The only requirement, according to them, is that the discretionary power should be exercised in good faith.

In this case, the view of the learned judges was that the ordering of investigation is merely an administrative order in the nature of fact finding inquiry to investigate the company in order to find out what has
been going on, in other words to find the facts. If it appears to the Board of Trade that there are circumstances suggesting (i), (ii) & (iii) of clause (b), it can straight away appoint one or two inspectors to investigate the affairs of the company. But the existence of one or other circumstances (i), (ii) & (iii), though only to the satisfaction of the Board of Trade is a necessary requisite for ordering the investigation, otherwise there will be no good faith in the exercise of the power. Even though, the order is only administrative, as Lord Denning M.R. took care to observe "so long as the Secretary of State acts in good faith it is not incumbent on him to disclose the material, he has before him or the reason for the inquiry". This means, that while the existence of one or other circumstances in clause (i), (ii) & (iii) need only be to the subjective satisfaction of the Secretary of State or the Board of Trade, and neither the material nor the reason for ordering the investigation need be disclosed, the ordering of the investigation itself should be made in good faith not based on extraneous circumstances.

However, Lord Denning M.R. has made the following categorical statement:
It is one of the elementary principles of natural justice, no matter whether it is a judicial proceeding or an administrative inquiry, that everything shall be done fairly and that any party or objector should be given a fair opportunity of being heard.  

Inadequate Information and Right of Members

As already seen a member of a company has right to be informed about the affairs of the company, its financial position etc. Inadequate information is that the members have not been provided with all the information with respect to affairs which they might reasonably expect from the company. Section 237(b) empowers the Central Government to appoint inspector in certain cases where there have been failure on the part of the company to provide information. This clause is important from the point of view of duty of disclosure. However, it does not provide any right to the member of the company. Therefore, it may be submitted that, in addition to the power of the Central Government to appoint inspector, members of the company may be given right to apply to the Central Government for the investigation of the affairs of the company by inspection.
Further, the Sacher Committee, not satisfying with the existing provisions has recommended for enlargement of the scope of clause (b) of section 237, has recommended for the addition of the following clause in section 237.

"That the company has been guilty of persistent default in complying with the provision of the act".

2. INVESTIGATION OF THE AFFAIRS OF RELATED COMPANIES (SECTION 239):

As per section 239, if an inspector appointed to investigate the affairs of a company, think it necessary for the purpose of his investigation to investigate the affairs of any other body corporate which at any relevant time in the same management of group, he has power to do so. However, as a safeguard against the possible abuse of his power by the inspector some inbuilt provisions are made and according to them, the inspector must not exercise his power of investigating and reporting without first having obtained the prior approval of the Central Government. As per the proviso to sub-section (2) of section 239, before according its approval the Central Government must give the body corporate or person reasonable opportunity to show cause why such approval should not be accorded. No such provision is provided under section 237.
It may be submitted that his section provides for 'lifting the corporate veil' in order to discover whether or not a group exists. It is also essential for establishing the identity of the members. This section as amended in 1960 by the Companies (Amendment) Act of 1960 whose object was to plug the loopholes existing in the then provisions, because of which some companies have escaped the investigation of questionable or inter company loans or advances or investments of a questionable character.

It may be mentioned that though for the investigation of the affairs of a body corporate or person, Central Government approval is necessary, the examination of the person and the ordering of the production of documents and evidence by the same bodies corporate or persons for the purposes of clauses (a) and (b) (i), do not require Central Government approval and the inspector may take such action against them or any of the proceedings laid down in section 240, in other words after the approval of the Central Government the bodies corporate or persons will be at the mercy of the inspector.

In the case of Coimbatore Spinning and Weaving Co. Ltd. v. K.J. Srinivasan, it was held that the duties of an inspector are not judicial or quasi judicial.
He has only to investigate the affairs of the company and report thereon.

In order to provide an additional safeguard the Sacher Committee had recommended that the proviso to sub-section (2) of section 239 should be amended to provide that approval should be given after hearing by the Central Government in case of investigation under section 237(b) and by the Company Law Board in case of investigation under section 235 and 237(a).

In order to enable the inspector to carry out his investigation properly and to bring out the true facts, section 240 lays down provisions, imposing duty on the officers, employees and agents of the company, requiring them to produce books and papers which are in their custody or power and also for other assistance. Section 240 also provides for their examination on oath either by the inspector himself or by the Court on an application made by him. If any person refuses to answer questions he will be guilty of contempt. In addition to this provision, section 240A inserted by the Companies (Amendment) Act, 1960 confers on the inspector power of search and seizure of books, papers etc.
**Nature of Proceedings:**

Investigation proceedings are not in the nature of criminal proceedings as they are not based on the accusation of any person as having committed an offence punishable under any law.  

An important question arise as to whether the witness will get absolute privilege in the proceedings before the inspector.

In England it was held by the Court that "investigation proceedings not being a judicial proceedings but only investigatory and quasi judicial, one of the effects of this is that witness are not protected by an absolute privilege. This may discourage persons coming forward as witness to speak the truth.

Another point is about admissibility of evidence taken on oath. In Karak Rubber Co. Ltd. v. Burden, Brightman J. has held that only evidence taken on the oath will be admissible. But in India, the position is different one. Under the Indian Evidence Act there is no reason why admission made other wise than on oath may not also be admissible as against the persons making them. In recent English case, it has been held by Mckema J. that "answer given by an official or agent
during an examination under the corresponding English section 167(2) will be used in subsequent proceedings, civil or criminal against him. There is nothing to prevent the inspector relying upon answers given by way of admission, even though they are not given on oath."

Refusal to answer questions put by the inspector, if not reasonable, is also punishable, will be guilty of contempt. In Mckelland, Pope & Langley Ltd. v. Howard, it was held that whether the refusal is or is not reasonable is for the Court to decide and not for the inspector. But the inspector must act fairly, even though, he is free to act at his discretion. He is not subject to any set rules of procedure.

In another case the officers of a company which was engaged in a litigation in a foreign company refused to give any information to the inspector lest it should pass to the foreign party and adversely affect their case. The inspector gave every assurance that could reasonably be required, but still the director refused to give information and evidence. It was held that the director's refusal was unjustified.
3. **INSPECTOR'S REPORT (SECTION 241)**:

According to section 241 which is analogous to section 168 of the English Companies Act, 1948, an inspector appointed by the Central Government will be required to make a report to the Central Government. On receipt of the report the Central Government must forward a copy of the report to the company and also to the body corporate whose affairs have been investigated, but the Government is not bound to forward a copy of interim report. The Central Government may, if it thinks fit, furnish a copy of the report, on request and on payment of prescribed fee, to any person -

(a) Who is a member of a company or body corporate dealt within the report, and

(b) Whose interest as a creditor of the company or any other body corporate, appears to be affected.

3-A **NATURE AND SCOPE OF PROCEEDINGS AND REPORT OF INSPECTOR**:

As occasion may arise for understanding the nature and scope of the inspector's report in investigating cases, the following extracts from the judgement of the Court of appeal is worth noting:
Lord Denning M.R. "the inspector are not Court of Law. The proceedings are not judicial proceedings. They are not even quasi-judicial, for they decide nothing. The only investigate and report. They sit in private and not entitled to admit the public to their meetings. They do not even decide whether there is a prima facie case as was done in Wiseman v. Borneman (1969) 3 W.L.R. 706(H.L.).

But his should not lead us to minimise the significance of their task. They have to make a report which may have wide repercussion. They may if, they think fit, make findings of fact which are damaging to those whom they name. They may accuse some, they may condemn others, they may ruin reputation or careers. Their report may lead to judicial proceedings. It may expose person to criminal prosecution or to civil actions. It may bring about the winding up of the company and be useful itself as material for the winding up.

Witness should be encouraged to come forward and not hold back. Remember, this is not being a judicial proceedings the witness are not protected by an absolute privilege but only qualified privilege. Every witness
must, therefore, be protected. He must be encouraged to be frank. This is done by giving every witness an assurance that his evidence will be regarded as confidential and not be used except for the purpose of the report...

But the inspector must rely the evidence of a witness so as to make it the basis of an adverse findings unless they give the party affected sufficient information to enable him to deal with it.

Sachs L.J. "it seems to me as well as to Lord Denning M.R. very clear that in the conduct of the proceedings there must be displayed that measure of natural justice which Lord Reid in Ridge v. Baldwin, described as insufficient of exact definiton, but what a reasonable man would regard as fair procedure in particular circumstances"... starting very often with a blank sheet of knowledge, they (the inspectors) have to call for information in whatever way it can be obtained that may be by interview, it may be from statements obtained in writing, it may be by their exercising their powers under section 167 (3) to put questions to individuals either on oath or not on oath".

BUCKLEY L.J.

"If inspectors are disposed to report on the conduct of any one in such a way that he may as a consequence be
proceeded against, either in criminal or civil proceedings, the inspectors would give him if he has not already had it such information of the complaint or criticism which they may make of him in their report and of their reasons for doing so, including such information as to the nature and effect of the evidence which disposes them to report, as necessary to give the person concerned a fair opportunity of dealing with the matters, and they should give him such an opportunity.

What disclosure will be necessary for this purpose must depend upon the circumstances, of the particular case. It may not and I think often would not, in an ordinary case involved disclosing the identity of witnesses or the disclosure of transactions. It certainly would not normally involve offering an opportunity to cross examine witness, and indeed, it seems that inspectors could not compel a witness to submit to cross-examination, whether it would involve confronting the directors or officer concerned with any documentary evidence would depend upon the circumstances of the case. Until any inspectors has reached a stage at which he thinks that he will, or at least may have to report adversely on a director or officer, it will be premature for him to decide what, if anything, he should do to give the director or officer a fair chance of explaining the matter".38
The nature of investigation by the inspector before submitting their report is further discussed in Maxwell v. Department of Trade, according to which the inspectors are expected to conduct the proceedings fairly and where they find it necessary to criticise the conduct of any person in their report, to give him an opportunity of explanation in fairness to him they are not required to follow any rigid rule of procedure compelling them to give him a hearing as in a judicial proceedings.

3-B PUBLICATION OF THE REPORT:

The Central Government is also provided with discretion to make the report public by publication of it. So far as this provisions is concerned it may be submitted that publication of the report to the public should be made compulsory, particularly in the case of report containing adverse remarks against the management of the company. In this regard attention may be drawn to 'Company News and Notes' the official Organ of the Company Law Board, which says: "it has been decided by the Company Law Board that in important cases where the reports of investigation into the affairs of ownership of companies by inspector appointed for the purpose are likely to be
of interest to the general public, such report will be published. The criterion for section would be the size, the extent of public interest and participation, the nature of inquiry engaged in the extent of consumer and creditor's interest and the relationship, if any, with other companies fulfilling these requirements".

Evidentiary value of the Report:

In England it has been held that proceedings before the inspector are not judicial proceedings as the persons who are examined are not examined, cross-examined or re-examined as in judicial proceedings. The report by itself cannot be admitted as proving the facts contained therein.

However, in India as per section 246, the report of the inspector will be admissible in every legal proceedings as a evidence of the opinion of the inspector in relation to any matter contained therein. Looking to this it may be submitted that having regard to the procedure laid down in sections 240 and 246 of the Companies Act, which is more elaborate than the sections 167 and 171 of the English Act, it would appear that the decision in Re ...B.C. Coupler and Engineering Co.Ltd.⁴² (No.2), may not be good authority.
In Home v. Bentiric, it was held that the inspector's report is protected by an absolute privilege, quoted in Re Pergaman Press Ltd, wherein it was held that is not absolute privilege but only qualified privilege.

In India the Allahabad High Court was called upon to consider the question whether the Government could claim privilege in respect of the report of an inspector containing the result of his investigation. In this case a company's affairs had been investigated under section 239 and the report was submitted to the Company Law Board. Another company which was asking relief against the company under sections 397-398 for prevention of oppression and mismanagement, sought the production of the report in support. An affidavit was submitted by the company Law Board that the officers concerned had carefully considered the report and had come to conclusion that the report contained communications made in official confidence and that public interest would suffer if the report was disclosed prematurely, in the sense that it would affect the follow up action. Privileged was claimed under section 124 of the Indian Evidence Act, 1872, The Court noted the
contents of this section and felt that there should be no judicial interference in the decision of the officer, but that the Court should also satisfy whether the plea raised by the officer was tenable. The Court also noted the contents of section 123 under which also a privilege could be claimed as to documents which deal with the affairs of the State. After the comparison of section 123 and 124, the authorities established that section 125 would not permit the Court to summon the document but to decide the question whether it really deals with the affairs of the State by looking at the surrounding circumstances. On the other hand, section 124 would permit, the Court to look at the document to know whether the stand taken by the officer was justifiable in the circumstances. Applying the principle thus established to the report of the inspector under section 239A, Benerjee J. said "to reveal contents of such a document to the public before its acceptance by the Central Government would not be conducive to public interest as it may thwart further proceedings and investigation. Public interest demands that matters reported to the Central Government should first be considered by the Government... Further there may be comments on the correction of the report and this
this may preclude the inspector from making free and frank report... I am, therefore, of the opinion that a report of the inspector made under section 239 is not to be disclosed to the public before its acceptance by the Central Government... If it is found that the documents contain revelation which affect the public interest then in that event the public office cannot be compelled to produce the document or disclose the contents once the privilege is claimed on this count. In the present case, such a privilege has been claimed. 46

This case shows that the inspector report is privileged one. Further it may be mentioned that on the ground of public interest, authority, in the case of Companies Act, Company Law Board, can refuse to disclose the contents of the inspector's report. As disclosure is required to be made to protect public interest in the same way in the public interest authority may refuse disclosure. The principle of public interest can be used, both ways, for disclosure and also for non-disclosure, of course it depends upon the circumstances of each case.

4. CONSEQUENCES

The Central Government may, on the basis of the report of the inspector, decide to take any of the following actions:
Section 242 provides that if it appears to the Central Government that any person has been guilty of an offence for which he is criminally liable, it may prosecute such person for the offence. It has been made obligatory for all officers and other employees of the company to give the Central Government all assistance in connection with the prosecution. The officers and other employees who are bound to give assistance are, agent which includes any one acting or purporting to act for or on behalf of such company, body corporate and may include bankers, legal advisers and auditors. It also includes past as well as present officer etc. The term officer also includes trustee for debenture holders of such company or body corporate.

In the case of M. Vaidyanathan v. Sub-Divisional Magistrate, Erode, it was held that the special provisions relating to offences under this Act do not bar the cognizance of offences, if punishable under the Indian Penal Code.
grounds which are just and equitable under the circumstances or make an application for an order for prevention of oppression or mismanagement under sections 397 or 398.

In two English cases, it has been held by Pennycuik J. that though the report of the inspector is not evidence in the ordinary sense, it was material on which, if unchallenged, the Court could make an order for winding up of the company.

Whereas in the case of Re St. Diran Ltd. it was held that the inspector's report can be used to support a contributory's petition for winding up of the company on the just and equitable ground.

In India in Moolchand Gupta v. Jagannath Gupta & Co. (P) Ltd., it was observed that the intention of the legislature as gathered from this section appears to be that the Central Government should refrain from initiating action when the Court seized of the matter at the instance of a party. Even if on the report of inspector appointed under sections 235 or 237, it appears to the Central Government that it is expedient to apply for an order under section 397 or 398, the Central Government should not take any steps, if the Court is already seized of proceeding to wind up the company.
In order to discourage people from committing offences, particularly offences relating to property, the offender should be deprived of his ill gotten gain. It is generally believed that for property, an offender will prefer undergoing or bearing physical pain, it may be way of beating, torturing or imprisonment, than losing or parting with property or illgotten gain or wealth. It seems that the legislature has kept in mind this human psychology while incorporating section 244 in the Act. This section gives discretionary power to the Central Government for bringing proceeding in its own in the name of the company. Where it appears from the inspector's report that proceedings ought to be brought by the company or body corporate in public interest for the recovery of damages in respect of fraud, misfeasance or other misconduct in connection with the promotion of formation or the mismanagement of the affairs of such a company or for the recovery of any property mis-applied or wrongfully restrained.

Under this provision, proceedings may be taken against promoters, directors or any person connected with the formation or management of the affairs of the company.
It may be mentioned that there is no provision as to what is to be done with the damages or property recovered as a result of the proceedings taken under section 244. As per the provision, the Central Government is to act on behalf of the company or body corporate in the representative capacity and therefore, damages or property recovered are to be paid or delivered over to the company or body corporate concerned.

So far as sub-section (1) of section 244 is concerned, a question arise as to the interpretation of the expression 'or other misconduct', whether it is to be interpreted ejusdem generis with fraud or misfeasance or otherwise. In an English case it was held that the expression 'or other misconduct' in sub-section (1), clause (a) of section 169, corresponding to sub-section (1) of section 244 of the Companies Act, should not be interpreted ejusdem generis with the fraud or misfeasance but may be taken to include also misconduct not involving moral turpitude.

5. INVESTIGATION OF OWNERSHIP OF COMPANY (SECTION 247-SECTION 172 OF THE ENGLISH ACT):

Sometimes, the identity of the beneficial owner of the shares of a company may be concealed by vesting shares
in trustees or nominees who are registered in the company's register of members. Same may happen in the case of debentures also. The real owners of the shares or debentures may be few in number and one of them, or a group of them acting together may, by giving direction to their trustees or nominees, be able to control the company by controlling voting at the meeting. Some of the beneficial owners may have interest inimical to the company, and may direct their trustees or nominees to vote in a way which will harm the interest of the company, or it may lead to take over bad. Though there is nothing illegal, but it has been considered desirable that there should be some machinery for making public the identity and interest of such equitable owners of shares and debentures. 52

In England Cohen Committee had emphasised the need for powers of investigation in such cases where the PUBLIC INTEREST requires the Government to know the persons who really control the company or materially influence its affairs. Accordingly, the English Companies Act, 1948 lays down the provisions for the investigation of ownership of companies in certain cases.
In India, extensive and wide power has been conferred on the Central Government, which enables it to investigate the ownership of a company and to acquire informations as to persons interested in any shares or debentures.

Section 247, empowers the Central Government where it appears to it that there is good reason to do so, to appoint one or more inspectors to investigate and report on the membership of any company and other matters relating to the company for the purpose of determining the real persons (a) who are or have been financially interested in the success or failure of the company, or (b) who are or have been able to control or materially influence the policy of the company.

5-A POWERS OF INSPECTOR:

Subject to the terms of appointment, the powers of the inspector extend to the investigation of any circumstances suggesting the existence of any arrangement or understanding which though not legally binding to be observed or is likely to be observed in practice and which is relevant to the purpose of his investigation. The inspector so appointed have the same powers in respect of seizure of document, evidence etc. as are enjoyed by the inspector appointed under section 235.
The investigation under this section is at the instance of the Central Government and not of any member, creditor or other person. On the conclusion of the investigation, the inspector is required to submit his report to the Central Government. As per the proviso to the section, Central Government is not bound to disclose the contents of the report to company or any person, if it is of the opinion that there are good reasons for not divulging the contents of the report or any part thereof. In such cases, a copy of such part of the report which is not confidential is required to be kept at the Registrar's office.

Here attention may be drawn to section 23(2) according to which the Central Government is bound to send a copy of the report to the company and other persons.

Section 248 provides that where it appears to the Central Government that there is good reasons to investigate the ownership of any shares in or debenture of a company, it may requires any person whom it has reasonable cause to believe.
(a) to be or to have been interested in those shares or debentures; or

(b) to act or to have acted, in relation to those shares or debentures, the legal advisers or agent of some one interested in such shares or debentures to give the Central Government the required information.

The matters requires to be disclosed are:

(i) his present or past interest in those shares or debentures,

(ii) the names and addresses of the persons interested; and

(iii) the names and address of persons who act or have acted on their behalf in relation to the shares or debentures.

IN order to avoid uncertainties, sub-section (2) provides that a person is deemed to have interest in a share or debenture, if any one of the following conditions is satisfied:

(a) if he has any right to acquire or dispose of the shares or debenture or any interest in such share or debenture or has voting right in respect or thereof, or
(b) if his consent is necessary for the exercise of any of the rights or other persons interested therein; or

(c) if other persons interested therein can be acquired or are accustomed to exercise their rights in accordance with his direction or instructions. In the similar way, ownership of any interest in a firm which has acted as managing agent or secretary and treasurer of any company may be investigated by the Central Government.

The notable feature of this section is that though it falls within the scheme of investigation, it does not involve investigation by any independent agency. It enables the Central Government itself to collect the information from the concerned person to investigate the ownership of any shares or debentures.

It may be mentioned that from the wording of the section, it seems that the liability of person to give information is not absolute. As per sub-section (1) the person summoned is required to give only those information, which he is or can reasonably expected to obtained. Accordingly, if a person, in the ordinary course of his duty is not supposed to have access to such
information cannot be summoned to give such information. The power given to the Central Government under this section is less drastic than the investigation by the inspector.

**Imposition of restriction upon Shares and Debentures and Prohibition of Transfer of Shares or Debentures in case of Investigation (Section 250):**

The object of section 250 which is corresponding to section 174 of the English Act, is to make the investigation effective by imposing restrictions where obstruction is sought to be placed in the course of investigation. It confers powers on the Central Government in a case, where, owing to change in the ownership of shares, a change in management of a company is likely to take place, while, if permitted, would in its opinion, be prejudicial to the public interest, to direct by an order that for a specified period, voting right shall not be exercised by the transferee of those shares.

As per sub-section (5) the Central Government may, by order at any time, vary or rescind any order made by it under sub-section (1), (3) or (4). However, it is not provided that who can apply for variance or rescission. Here attention may be drawn to sub-section (6) which provides that where central Government makes an order or refueses
to rescind any order, any person aggrieved by the order of the Central Government may apply to the Court. This suggest that any person can apply to the Central Government either for variance or rescission of the order made by it under sub-section (1), (3) or (4). On appeal the Court may, if it thinks fit, by order, vacate any order of the Central Government. Before passing an order the Court is required to give the Central Government an opportunity of being heard. The order of the Court may be conditional. In an English case the Court released the restriction on transfer to enable the shares to be acquire under section 209 after a take over, but maintained the restrictions on payment thus freezing price payable.

By the Companies (Amendment) Act, 195 a new section 250A was inserted, which provides that investigation may initiated notwithstanding the voluntary winding up or the pendency of such application in the Court. The object of this new provision is to make ineffective the methods by which investigation was sought to delayed. One of the Methods was by raising technical objections on the ground of the voluntary liquidation of the company or pendency before the Court of certain applications for relief against mismanagement and oppression. As per the new section, now this method can not be adopted.
A very important exception has been created to the principle of disclosure by section 251 which is analogous to section 175 of the English Companies Act. It provides that a legal adviser need not disclose to the Registrar, or to the Central Government or to an inspector a privilege communication made to him quo legal adviser, except the name and address of his client. Ordinarily the communication between the legal adviser and his client is considered as privilege communication and therefore legal adviser cannot be compelled to disclose facts of that communication to any person.

Section also provides exception in favour of Banker of the company, and accordingly the banker need not disclose to any of them any information as to the affairs of his customers. It may be submitted that the privilege in the case of Banker is a limited privilege and extends only as regards the Banker's other customers and no information as regards the company, body corporate, etc. referred to in sections 235 to 250 can be withheld.

In the case of Minter v. Priest, it was held that neither in the case of banker nor legal adviser can the privilege be availed of in furtherance of a crime or fraud.
Further it may be mentioned that though they cannot be compelled to disclose the information, but there is no restriction on their voluntarily disclosing any information.

6. INVESTIGATION OF ASSOCIATESHIP WITH MANAGING AGENT ETC: (Section 249):

Where any question arise as to associates of a managing agent or secretary and treasurer or in other words as to whether an individual, a firm or a company was or was not an associate of a managing agent or secretary and treasurer of any company, section 249 empowers the Central Government to investigate it either directly by collecting information from any person whom it has reasonable cause to believe to be in a position to give relevant information in regard to the question or it may appoint inspector for the purpose of making the investigation.

It may be mentioned that this section is new and there is no corresponding provision in the English Act.

So far as this section and sub-section (3) of section 248 are concerned, it may be submitted that the system of managing agency, and secretary and treasurer was abolished with effect from 3-4-1970 by the Companies (Amendment) Act, 1969. It seems the utility of the above mentioned provisions has already come to an end and looking to the time which has elapsed i.e. of more than 15 years, it will be advisable to delet these provisions from the Statute Book.
Often times limited companies are landed in difficulties and the interests of the members and creditors are seriously affected, particularly creditors. The difficulties are not necessarily caused by any mismanagement or fraudulent behaviour of persons managing the affairs of the company. The companies consider, in the circumstances, that if the creditors and members would reduce their claims, it is possible to run the company and put it again on its legs. The relief desired by the company may in the shape of reduction of debt or of the rate of interest or of acceptance of shares in lieu of debentures. There may be many ways of obtaining relief. For the said purpose often times, the company proposes a scheme of arrangement or compromise with its creditors and members. Arrangement and compromise mainly takes place because of the bad financial position of the companies. For example, on account of heavy loses the company may not be in a position to pay interest to the debenture holders at the agreed rate. They may, therefore, be requested to agree for a lower rate of interest under the scheme of arrangement. But sometimes perfectly sound companies may also like to reorganise their
capital. The schemes of arrangements and compromises may also become necessary for purposes of reconstruction and amalgamation of companies. Thus, scheme of compromise or arrangement can be made applicable to a going concern as well as to a company in liquidation. In most cases the schemes are framed with a view to reduce financial burden on companies so that they may be saved from being wound up.

The Companies Act, 1956 regarded as progressive piece of legislation makes statutory provisions regarding this matters in sections 391 to 394. These provisions are applicable to all companies liable to be wound up under the Companies Act, 1956.

2. SCHEME UNDER THE ACT:

Section 391 gives power to compromise or make arrangement with creditors and members and apply to the Court for convening a meeting of creditors or members concerned and the procedure to be adopted on such application being made.

Section 392 gives power to the High Court to make consequential order of supervision and to enforce the carrying out of the arrangement or compromise.

Section 393 imposes a duty on the company to give full information to the creditors or members concerned as to the details of the scheme of compromise or arrangements proposed.
Section 394 lays down the procedure for the reconstruction or amalgamation of the companies. In the case of dissenting shareholder section 395 gives power and duty of a transferee company to acquire their shares.

Lastly in cases where national interest so requires power is given to the Central Government under section 396 to provide for amalgamation of certain companies. In this connection sections 494 and 507 gives power to the liquidator to accept shares etc. as consideration for sale of property of the company.

**MEANING:** The term 'compromise' refers to an amicable settlement of difference by mutual concession by the parties to the dispute. It implies the existence of a dispute such as relating to rights. It also involves element of give and take, and the Court will not sanction a scheme involving a total surrender of rights on one side with no compensating advantage. Like individuals, companies often find it necessary to enter into compromise with their creditors or members and the settlement arrive at is termed as compromise.

The term 'arrangement' is of very wide import. All modes of reorganising the share capital, including interference with preferential and other special rights attached to shares, can properly form part of an arrangement with
members. The term arrangement is wider than the term compromise is now accepted fact. In re Guardian Assurance Company's case a scheme was submitted to the Court which provided that each shareholder of the petitioning company should transfer some of his shares to another company and its shareholders. YOUNGER J. rejected the scheme on the ground that there was no dispute or difficulty to be resolved by compromise or arrangement. The court of Appeal rejected the contention of Younger J. and sanctioned the scheme as arrangement since the word's 'arrangement' could not be limited to something analogous to a 'compromise'.

A scheme of amalgamation between two companies has been held to be an 'arrangement' not only between the transferor company and its members but also between the transferee company and its members, and therefore, all provisions of the Act regarding 'arrangement have to be complied with.59

The term 'reconstruction' is generally used where only one company is involved and the rights of its shareholders and creditors are varied, and 'amalgamation' is used where two or more companies are amalgamated or where one is merged in another or taken over by another.

According to Halsbury's laws of England, neither reconstruction nor amalgamation has a precise legal meaning.
where an undertaking carried on by a company and is
substance transferred, not to an outsider, but to another
company consisting substantially of the same shareholders
with a view to its being continued by the transferee company,
there is a reconstruction. It is non the less a reconstruc-
tion because all the assets do not pass to the new company,
or all the shareholders of the transferor company are not
shareholders in the transferee company, or the liabilities
of the transferee company, or the liabilities of the
transferor company are not taken over the transferee company.

Amalgamation is blending of two or more existing
undertakings into one undertaking, the shareholders of
each blending company becoming substantially the share-
holders in the company which is to carry on the blended
undertaking.

According to Lindley M.R. 'amalgamation does not involve
the formation of a new company to carry on the business
of an old company. In the case of S.S. Samayajulu v.
Hope Prudhomme & Co.Ltd. the Andhra Pradesh High Court
held that 'amalgamation is a state of things under which
either two companies are so joined as to form a third
entity or one is absorbed into or blended with another.
It may be mentioned that provisions of sections 391, 394, 394A and 395 were amended by the Companies (Amendment) Act, 1965 on the recommendation of the Daiphaty-Sastri Committee. The notable feature of those recommendations was emphasis given for necessity of disclosure in the case of amalgamation etc. The Committee observed:

"With the active support of a liquidator a scheme of amalgamation with respect of a company in voluntary liquidation was presented to the Court and sanction of the Court was obtained, without disclosing material facts to the Court. Such as improper transfer of assets, the existence of an order for an investigation into the affairs of the company; and the latest financial position of the company, and that of the transferee company. In order that Court may not proceed to sanction an arrangement or amalgamation with too little material on record and without information as to important facts, which if they were presented before the Court, would weigh heavily against the sanction of the scheme". In order to have fullest disclosure of all material facts, the Committee made certain recommendations, on the basis of which a new provisions were added in section 391 (2), and section 394 (1) and a new section 394A was inserted. In addition to this section 395 was also amended.
Function of Court: The section 391 gives the Court discretion to approve any sort of arrangement between the company and its shareholders. This power of the Court to sanction and compromise or arrangement is subject to the conditions laid down under the proviso to sub-section (2) of section 391.

Section 391(2) provides that once a compromise or arrangement is sanctioned by the Court, it becomes binding on all the creditors and members and in the case of a company which is being wound up, on the liquidator and contributories of the company. The proviso to sub-section (2) lays down that Court should not make order sanctioning any compromise or arrangement unless the Court is satisfied that the company or any other person by whom an application has been made under sub-section (1) has disclosed to the Court by affidavit or otherwise, all material facts relating to the company, such as the latest financial position of the company, the latest auditor's report on the accounts of the company, the pendency of any investigation proceedings in relation to the company under section 235 to 251 and the like.

As mentioned, this proviso was added by the Companies (Amendment) Act, 1965 on the recommendation of Daphatry-Sastri Committee. The object of this proviso is to see that before the Court sanction any compromise or arrangement,
all material facts are brought to the notice of the Court. This duty of disclosure laid down by the proviso is very important, looking to the effect of the order of the Court. The scheme when approved by the Court, becomes binding on all parties to it including dissentients, so that whether it is valid or not, a shareholders cannot afterwards question it. It is statutory force and has greater sanctity than a mere agreement between the parties affected. It cannot be varied by a mere agreement of parties.  

In re Coimbatore Cotton Mills Ltd and Lekshmi Mills Co. Ltd the Court laid down the principles for sanctioning the scheme as follows:

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

(2) The Court should satisfy itself that those who took part in the meeting are fairly representative of the class and that the statutory meeting did not coerce the minority in order to promote the adverse interest of those of the class whom they purport to represent.

(3) Lastly, in exercising its discretion under section 391 and 394, the Court is not merely acting as a rubber stamp. It is the function of the court to see that the scheme as a whole, having regard to the general conditions and background and object of the scheme, is a reasonable one and if the Court so finds, it is not for the Court to interfere with the collective wisdom of the shareholders of the company. When once the court finds that the scheme is unfair and that, therefore, the Court should exercise the discretion to reject the scheme notwithstanding the views of a very large majority of the shareholders that the scheme is a fair one. If the Court is of the opinion that there is such an objection to it as any reasonable man would say that he would not approve of it, then the Court may refuse to confirm the scheme. However, if the scheme as whole is fair and reasonable, it is the duty of the Court not to launch on an investigation upon the commercial merits or demerits of the scheme which is the
function of those who are interested in the arrangement.

(4) There should not be any lack of good faith on the part of the majority.

3-B. DISCLOSURE OF INFORMATION AS TO COMPROMISE (Section 393-Section 207 of the English Act):

Section 393 requires that with the notice calling the meeting of the creditors or members under section 391 for the approval of the scheme, the company must send a statement setting forth the following information:

(1) the terms of the compromise or arrangement and explaining its effects.

(2) any material interests of the directors, managing director or manager of the company, qua director, managing director or manager or as a member or creditor of the company, or in any other capacity.

(3) the effect on those interests, of such compromise or arrangement, particularly when the effect will be different then the effect on the interest of other persons.

If proper information is not given to the creditors or members, the Court will refuse to sanction the scheme, even if it was approved by the requisite majority. It may be stated that non-disclosure of matters specified in sub-section (1) (a) would be fatal to the proposal of the
scheme of compromise, arrangement or amalgamation.

In an English case it was held that the scheme will not be sanctioned if the explanatory statement, while stating that the company's assets have been revalued, does not give the amount of revaluation. However, in another case it was held that omission to disclose information not required to be disclosed even though the omission may be deliberate, does not preclude the Court from sanctioning an arrangement, if the scheme is otherwise fair.

Even in the case of meeting of which notice have been given through advertisement, the above particulars should be included in the advertisement or instead of that a notification of the place at which and the manner in which creditors or members entitled to attend meeting may be obtained copies of the statement disclosing all facts must be included.

It may be stated that this section incorporate the provisions of section 207 of the English Companies Act, 1948 as recommended by the Committee Law Committee. Important omission is in respect of persons whose interests are required to be disclosed. Trustee of debenture holders is omitted.
Section 394 provides for such consequential order as may be necessary to give effect to a scheme or arrangement. The Court may either by the order sanctioning the scheme or by a subsequent order make provisions for the various matters set out in sub-section (1) including reconstruction and amalgamation. The procedure under this section is adopted either when dealing with the application under section 391 or after order is made therein.

The powers of sanctioning the scheme conferred on the Court by this section is subject to two provisos added to sub-section (1) by the Companies (Amendment) Act, 1965.

The first proviso provides that a compromise or amalgamation proposed in connection with a scheme for amalgamation of a company which is being wound up, with any other company should not be sanctioned by the Court unless the Court has received a report from the Company Law Board or the Registrar that the affairs of the company have not been conducted in a manner prejudicial to the interest of the members or to public interest. This proviso provides for disclosure of material facts of the affairs of the company to the Court. Whereas the second proviso deals with
the dissolution of the transferee company. It provides that 'no order for the dissolution of any transferor company under clause (iv) of sub-section (1) (B) shall be made by the Court unless the Official Liquidator has, on scrutiny of the books and papers of the company, made a report to the Court that the affairs of the company have not been conducted in a manner prejudicial to the interest of its members or to public interest.

The object of calling for the report of the company under which either two companies are so joined as to form a third entity or one is absorbed into or blended with another.

The object of calling for the report of the Official Liquidator is to satisfy the Court that the interest of the members or public interest are not prejudicially affected by the amalgamation. In this connection the case of In re Wood Polymer Ltd. shows that clause (iv) of sub-section (1) (b) is applicable to the transferor company in all cases of amalgamation. As pointed out therein, the Court is precluded from making an order for dissolution unless the Official Liquidator has, on scrutiny of the books and papers of the company made or reported to the Court that affairs of the company have not been conducted in a manner prejudicial to the interest. If the object and purpose of amalgamation,
as found, in that case, was to get the benefit of avoidance of capital gain tax, it would be prejudicial to the public interest, eventhough that did not amount to tax evasion or other illegal act or conduct. The Court in such case would not extend its helping hand to help to do anything which will have the effect of defeating the tax law of the country, though in a legal manner. In a recent decision in the case of In re Marybong & Kyel Tea Estate Ltd. while determining the application of second proviso to sub-section (1) it was held that the second proviso which required a report from Official Liquidator to the effect that the affairs of the company have not been conducted in a manner prejudicial to the interests of its members or to public interest will apply only to cases where the transferor company is in the process of winding up.

It may be respectfully submitted that this view obviously ignores the fact that Clause (v) of sub-section (1) (b) expressly covers all cases of dissolution without winding up, whether winding up proceedings inrespect of the company are pending or not.

Recognising the importance of disclosure to be made by the Company Law Board of Registrar under first proviso to the Court, in the case of Sumani (P) Ltd. it was held that the obtaining of reports required by the two proviso is a condition pre-requisite before ordering dissolution of the transferor company.
The Sacher Committee, after taking into consideration, the different view expressed by different Courts in respect of second proviso, came to the conclusion that it is not necessary for the Official Liquidator to make scrutiny of the books and papers of the Company and report to the Court that the affairs of the Company have not been conducted in a manner prejudicial to the interests of its members or public interests before the company can be dissolved. In case of amalgamation, the matter is before the Court, and the Court is expected to protect the interest of every body concerned, it is not appreciated why a further report by the Official Liquidator should be necessary. It has therefore, recommended for the deletion of the provision. It has also recommended that, it should be provided in the section that at the expiry of six months after a certified copy of the order of the Court approving the scheme of amalgamation is filed with the Registrar, transferor company should be deemed to have been dissolved.\(^6\)

So far this recommendation is concerned it may be submitted that these two provisions were added on the recommendation of Vivian Bose inquiry Commission in Dalmia-Jain concern, as additional safeguards. There is no reason for deletion of these additional safeguards.
This section is new and inserted by the Companies (Amendment) Act, 1965. It imposes a statutory duty on the Court, firstly to give notice of every application made to it under section 391 and 394 to the Central Government and secondly to take into consideration any representation made to it by the Central Government before passing any order under any of these sections.

The object of this section as stated in the Notes on Clauses is to enable the Central Government to study the proposal and raise such objection thereto as it think fit in the light of the facts and information available with it, and also place the Court in possession of certain facts which might not have been disclosed by those who appear before it so that the interests of the investing public at large may be fully taken into account by the Court before passing its order.

It may be mentioned that nothing is said about the point of time of giving notice to the Central Government. This point was the matter of contention in the case of Bhangeswari Cotton Mills Ltd. The Calcutta High Court held that the notice need not be given at the initial stage before calling a meeting of the members and creditors.
and it is enough if it is given before the Court's makes a final order sanctioning the compromise or arrangement. Where in Re. .... Beardsell & Co. Ltd., it was held that it is only notice of the scheme as approved by the shareholders that has to go to the Central Government for remarks before sanction is accorded by the Court.

It may be submitted as per the existing provisions or section 394A, the Court is required to give notice to the Central Government at second stage and not the first stage, the first stage is application stage including calling and holding of meeting of members and creditors. Adds which to delay. In order to cut down delay, avoid duplication of proceedings and incidently reduce litigation cost, the Sacher Committee has rightly recommended that:

Companies registered under M.R.T.P. Act are concerned no change has been recommended by it. However, in cases where the question as to whether the company is liable for registration under section 26 of M.R.T.P. Act or not, has not been finally decided and the matter is pending before the Central Government or the Commission, then in such a case, the companies being a party to the scheme of amalgamation could file the petition in the Court as per the existing provisions, but with this modification that in such a case the applicant company/companies must mention
in the petition the fact of the question of registration under section 26 being under determination and also state the grounds as to why the company/companies is/are not liable to be registered under section 26. The Court, while disposing of the petition, may either await the final decision on the matter of registration or make other appropriate orders.

In the case of companies which do not fall within the purview of the M.R.T.P. Act, the existing procedure continue except:

(a) single stage procedure commencing with a company petition on which the Court will issue notice to the Central Government, the Ministry/Department concerned with the business activity of the amalgamating company and such other person/authority whom the Court considers it necessary to be heard before passing a final order.

(b) With a view to affording sufficient time to the Government Departments Authorities, the applicant company should serve an advance copy of the petition to the Central Government/Department and make a statement to that effect in the affidavit of service prescribed in Form 7 of the Companies (Court) Rules 1959, and

(c) Instead of both the amalgamating company and the amalgamated company making two separate applications either
in the same Court or in different Courts, there should be only one joint application to be made by the parties to the scheme of amalgamation. The joint petition should be filed in the Court where the registered office of the amalgamated company is situated.

It may be submitted that if those recommendations are implemented certainly they would widen the scope of section 394-A and would also avoid unnecessary delay.

3-E DISCLOSURE REQUIRED TO BE MADE AT THE TIME OF ACQUISITION OF SHARES OF DENTING SHAREHOLDERS:

It may be mentioned that section 395 is a verbatim reproduction of section 209 of the English Act, except subsection (4-A) inserted by the Companies (Amendment) Act, 1965.

It provides for another type of arrangement or amalgamation and does not require any application to the Court on the lines of section 391, for carrying out the scheme. In this case, it is for the transferee company to make an offer to the shareholders of the transferor company at a stated price which is usually higher than the prevailing market price. In short section 395 authorises the transferee company to acquire shares of dissenting share-holders in the transferor company, as per the provisions of the section.
**Duty of transferee company**:

For the purpose of acquisition of shares, the transferee company is required to give notice of its intention to acquire shares to the dissenting shareholders. Within one month of notice, any dissenting shareholders may apply to the Court. The Court will interfere if the transaction appears to be manifestly oppressive, unjust, unfair or unconscionable or the consent of majority has been obtained by fraud, deception or other improper means.

If no application is made to the Court or the Court refuse it, the transferee company become entitled to acquire the shares of all persons on whom notice is served. In fact, the transferee company is entitled and bound to acquire those shares on the terms on which the shares of other shareholders are to be transferred subject to the other provisions of the section.

This power of acquisition of shares of dissenting shareholders is made subject to important conditions laid down under sub-section 4A of the section. This sub-section was incorporated for checking the malpractices in relation to the 'take over' offer and acquisition of shares of dissenting shareholders under scheme or contract approved by the majority. Now it ensure that adequate information
is disclosed in a take over offer, to the shareholders so that they could be allowed to judge for themselves whether or not to accept the offer. For this purpose its provides that:

(a) every such offer or every circular containing such offer or every recommendation to the members of the transferor company by its director to accept such offer shall be accompanied by such information which is likely to affect the willingness of a shareholder to accept the offer.

(b) Every such offer shall contain a statement by or on behalf of the transferee company, disclosing the steps it has taken to ensure that necessary cash will be available. It must also disclose the steps taken by it for collecting necessary cash for payment of the price of acquired shares.

(c) Every circular containing or recommending acceptance of such offer, shall be presented to the Registrar for registration and no such circular shall be issued until it is so required. This clause also empowers the Registrar to refuse registration of such circular (i) where it does not contain the prescribed information or (ii) which sets out information in a manner likely to give false information.

It may be stated that sub-section 4-A provides additional safeguards to the shareholders of the transferor
From the information disclosed in the circular, a shareholder may ascertain the benefits or otherwise of the scheme, and secondly, it also confers power on the Registrar to refuse registration of the circular if it is likely to mislead the shareholders.
References:


5. The Registrar V. Board of Trade (1965) 1. Q.B. 603.


9. (1843) 2 Hare 461.

10. AIR 1967 Cal. 406


13. In re Alembic Glass Industries Ltd. (1972) 42 Comp. Cases 63 (Guj.)


16. (1975) 45 Comp. cases 33 at 483.
17. (1977) 3 W.L.R. 300
18. (1966) 2 Comp. L.J. 151 (P.186)
20. Modi Industries Ltd. v. Union of India (1982) 52 Comp. cases 589 (Del.)
21. Leitch (William C.) Bros, Ltd. Re. (1932) 2 Ch. 71.
22. (1981) 51 Comp. Cases 634 (Del.)
23. Norwest Hoist Ltd. v. Secretary of State for Trade (1938) 3 All E.R. 280 (Ch. & C.A.)
24. Section 165 (b) (ii) of the English Companies Act.
27. Sahu Jain Ltd. v. Deputy Secretary, Ministry of Finance (1965)2 Comp. L.J. 145.
29. Re Gaumont British Picture Corporation (1940) 2 All E.R. 425 (Ch.D.)

34. Re Gaumont British Picture Corporation (1940) All E.R. 425 (Ch.D.)

35. (1968) 1 All E.R. 669 -


37. Sub-section (2) of section 241 of the Act.


42. A.B.C. Coupler and Engineering Co. Ltd. (No.2) (1962) 3 All E.R. 68 (Ch.D.)

43. (1829) 2 B & B 130.


47. (1957) 27 Comp. Cas. 97.

48. In Re S.B.A. Properties Ltd. (1967) 2 All E.R. 615 (Ch.L.) and In Re Travel & Holiday Clubs Ltd. (1967) 2 All E.R. 606 (Ch.L.).


54. 1930 A.C. 558.

55. Sneath v. Valley Gold Ltd. (1893) 1 Ch. 477.


58. (1917) 1 Ch. 431 p.441.


63. (1980) 50 Comp. Cases 623 (Mad.) at 630.

64. Dorman, Long & Co. Ltd. Re. (1934) Ch. 635

65. In re National Bank Ltd. (168) 1 All E.R. 100 (Ch.D).

66. (1977) 47 Comp. cas. 597 (Guj).

68. (1979) 49 Com. Cases 547 (Bom.).


70. (1966) 1 Comp. L.J. 261 ; (1967) 37 Comp. Cas. 195 (Cal.)

71. (1968) 1 Comp. L.J. 102 ; (1968) Comp. Case 197 Mad.


73. Vishwanathan v. East India Distilleries Ltd. (1957) 27 Comp. Cas. 175.