

IN THE HIGH COURT OF JUDICATURE AT BOMBAY**ORDINARY ORIGINAL CIVIL JURISDICTION****COMPANY APPEAL NO. 10 OF 2009****IN****CLB COMPANY PETITION NO. 17 OF 2007**

Mr. Bharamgouda Adgouda Patil,
since deceased through his legal heirs
and representatives

(a) Smt. Pragati B. Patil & Ors.

...Appellants

vs.

Sanjay Founders Pvt. Ltd. & Ors.

...Respondents

.....

Mr. V.P. Sawant, i/b. Mr.,P.M. Jadhav, for Appellants.

Mr. Sean Wassodew with Mr. Rupesh Mandhare, for Respondent Nos.1 to 5.

Mr. Inderprakash Tripathi with Ms. Bhagyashri Gawas, i/b. Mr. Akhilesh Singh, for Respondent Nos.6 to 9.

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CORAM : S.C. GUPTE, J.

27/28 JULY 2015

P.C. :

. The appeal challenges an order passed by Company Law Board ('CLB') rejecting a petition of the Appellants under Sections 397 and 398 of the Companies Act, 1956 ('the Act').

2. The Appellants between them claim to hold about 46.71% share of the first Respondent company. The first Respondent company is claimed to be in the nature of a quasi-partnership. The grievance of the

Appellants in the petition is this: The predecessor of Appellant Nos.3 to 7, late Shankarrao Mahadeo Bidkar, was a member of the first Respondent company during his lifetime, holding 671 shares in the company, and also the Chairman of its Board of Directors. The late Shankarrao Bidkar was ill since December 2002 and could not effectively contribute to the business activities of the company and as a result, Appellant No.3 was appointed as a director on or about 15 June 2003. Shankarrao expired on 20 January 2005. After the death of Shankarrao, when his legal heirs started making inquiries about the shares held by their father, they came to learn through a copy of an annual report for the year 2003-2004 that the Board of Directors had transferred 536 out of 671 shares held by the late the Shankarrao on 25 March 2003 to Respondent Nos.6 to 9. It is the case of the Appellants that a scrutiny of the share transfer forms used for the purported share transfers made it apparent that the share transfer forms contained several interpolations; thumb impressions of the late Shankarrao obtained on the forms were forged; the transfer forms used were beyond their validity periods; the stamp duty paid thereon was in contravention of the provisions of the Stamp law; and that for these reasons and otherwise also, the transfer of shares was contrary to Section 108 of the Act. It is submitted that the transfer was also in contravention of Article 11 of the Articles of Association of the first Respondent company, since no shares could be transferred thereunder without allowing the existing shareholders to exercise a right of pre-emption. It is submitted that there was a malafide intention on the part of the Respondents to oust the Appellants from the management of the first Respondent company. It is submitted that after the demise of Shankarrao, all his legal heirs demanded outstanding amounts in the account of late

Shankarrao, but this was not done. No proper notices of Annual General Meetings were given to the Appellants and no AGMs were properly convened. The Appellants have also made reference to certain statements of the auditors about acceptance of deposits from public and non-compliance with statutory provisions in respect thereof as also to the various defaults in repayment of the dues by the first Respondent company to SICOM. On the basis of these submissions, it is the Appellants' case that the affairs of the first Respondent company have been conducted by the Respondents in a manner oppressive to the Appellants and also in a manner prejudicial to public interest and to the interests of the company. The petition is filed on 10 February 2007. The Appellants pray for various reliefs in the petition. They *inter alia* seek cancellation of the transfers registered on 25 March 2003 in respect of 536 shares of late Shankarrao and rectification of the register by restoring the name of Shankarrao in the first instance and then by registering the names of Appellant Nos.3 to 7 as legal heirs of late Shankarrao. They also seek reliefs for cancellation of decisions taken in AGMs and board meetings of the first Respondent company including decisions for appointment of Respondent Nos.5 and 6 as directors.

3. The CLB, in the impugned order, rejected the Appellants' contention insofar as the application for rectification of the register of members was concerned. The CLB noted that there was no application made for rectification of register under Section 111 of the Act and the provisions of Sections 397 and 398 of the Act were not attracted for this purpose. The CLB was of the view that the issue of transfer of 536 shares of late Shankarrao being fraudulent and obtained by forged documents

could not be adjudicated upon by the CLB. The CLB also found that the Appellants had failed to make out a case of harsh, burdensome and wrongful conduct on the part of the Respondents and mere procedural defects / irregularities in the transfer of shares could not be held oppressive to the Appellants. The CLB also found no merit in the alleged procedural defects and irregularities pointed out in the holding of AGMs as well as appointment of directors. The CLB rejected the Appellants' allegations that the funds of the first Respondent company were being mismanaged. The CLB, accordingly, found that none of the prayers in the company petition could be granted. The CLB, however, found that there was no dispute that the first Respondent was a quasi-partnership and the ouster of Appellant Nos.1 to 3 was against the principle of quasi-partnership, but that since the Appellants had not come with clean hands before the CLB in exercise of its equitable jurisdiction, there was no case for grant of any reliefs. (This observation was later on substituted by an observation that the first Respondent was undoubtedly a quasi-partnership, on the application of the Respondents.) The CLB, however, held that keeping in view the facts and circumstances of the company, which was a family company in the nature of a quasi-partnership, wherein the petitioners held more than 46% shares (even this observation was amended to the effect that the Appellants claimed to be holding more than 46% shares), the first Respondent company was directed to give adequate representation to the Appellants in the management of the business of the company.

4. Being aggrieved by this order, the Appellants have preferred the present appeal under Section 10F of the Act. The Respondents have

submitted cross objections. It is the case of the Respondents that the CLB could not have come to the finding of quasi-partnership without considering the rival contentions of the parties. It is submitted that the Respondents have submitted all particulars showing the transfers and issue of shares to various outsiders and third parties from time to time as well as several changes in the composition of the management of the first Respondent company, which clearly negates the case of quasi-partnership. It is submitted that none of the principles of quasi-partnership as discussed in the case of **Synchron Machine Tools Pvt. Ltd. vs. U.M. Suresh Rao**¹ are made out in the present case. The Respondents, accordingly, object to the direction regarding giving of an adequate representation to the Appellants in the management of the first Respondent company.

5. It is seen from the record of the case that the transfer of 536 shares was made purportedly as part of a family arrangement between the late Shankarrao and his brothers; it was made during the lifetime of Shankarrao; it was backed by transfer deeds purportedly executed by the late Shankarrao in favour of his four brothers - Respondent Nos. 6 to 9; there is a board resolution as of 25 March 2003 duly recorded in the Minute Book maintained by the first Respondent company accepting such transfer and providing for its registration; the transfer is recorded in the original share certificates; the Annual Report of the first Respondent company of the year 2003-2004 reflects this transfer and shows the names of all the transferees; and finally, the AGM of the first Respondent company immediately following such transfer is admittedly attended by the transferees as members of the first Respondent company in the

1 1994(079)-COMPCAS-0868-KAR

presence of Appellant No.3, who attended as a proxy of the late Shankarrao (who continued to hold 135 shares after the transfer). The conclusion of the CLB in the backdrop of these facts that the issue concerning the transfer of 536 shares being made fraudulently, that is to say, by forging the signatures or overwriting the transfer forms, etc., could not be adjudicated upon by the CLB, cannot be termed as an impossible or perverse conclusion.

6. Learned Counsel for the Appellants submitted that the registration of the subject transfer of shares was in contravention of Section 108 of the Act. This was a petition under Section 397 of the Act alleging acts of oppression on the part of the Respondents and not a rectification application under Section 111. It is not sufficient for the Appellants to simply make out a case of an irregular, or even an illegal, transfer by reason of non-compliance with the provisions of Section 108 of the Act. It must be shown that such transfer was an act of oppression, showing a conduct involving at least an element of lack of probity or fair dealing towards the late Shankarrao in the matter of his proprietary rights as a shareholder. The apparent state of affairs discloses that the late Shankarrao was a party to the act, which was committed during his lifetime. Subject to the Appellants' right to go behind the act and show that the act was a fabrication and performed without the knowledge of the late Shankarrao, which would be a matter for a civil court to decide, mere non-compliance with Section 108 in such a case cannot be a ground to set aside a transfer of shares in a petition under Sections 397 and 398 of the Act, and that too much after the death of Shankarrao and about four years after the purported transfer. The Appellants had to show that

it was not only an oppressive act but that it was just and equitable to wind up the company on account of such act. The Appellants have clearly failed to make out any such case. Learned Counsel for the Appellants relied on the judgment in **Harikumar Rajah vs. Sovereign Dairy Industries Ltd.**² This judgment holds that the fact that a procedure is prescribed for seeking rectification of the register of members does not come in the way of a company court granting relief in respect of such transfer in a petition under Sections 397 and 398. That is undoubtedly so. But the point is that a case of oppression and mis-management must still be made out for granting of such relief. It is not simply sufficient to make out a case only for rectification under Section 111 for claiming such relief under Sections 397 and 398. In **Mannalal Khetan vs. Kedar Nath Khetan**³, the Supreme Court held the provisions of Section 108 to be mandatory. That case again has no bearing on the present controversy, which is specifically raised in the context of a grievance under Sections 397 and 398 of the Act.

7. Learned Counsel for the Appellants further submitted that the transfer was in contravention with Article 11 of the Articles of Association of the first Respondent company. Article 11 provides for the right of pre-emption of existing shareholders of the company in the case of a proposed transfer of shares. It is submitted that the transfer of 536 shares of the late Shankarrao was in contravention of this provision. Article 11 takes effect in a case which is not otherwise provided for under the Articles. It opens with the words "Except as herein provided". Article 10, which immediately precedes this Article, provides that notwithstanding the

2 SEBI & Corporate Laws – Reports Vol. 19, page 391

3 AIR 1977 Supreme Court 536

restrictions contained in the Articles, shares may be transferred by a member to another member or a person in any of the enumerated relationships with the transferor member. It is an admitted position that the transferees of these 536 shares are brothers of the late Shankarrao and fall within this clause. Learned Counsel for the Appellants relied on the judgments in the case of **John Tinson and Co. Pvt. Ltd. vs. Surjeet Malhan**⁴ and **Bhubaneshwar Singh vs. Kanthal India Ltd.**⁵ in support of his case that transfers of shares in contravention of the Articles of Association are invalid. There is no quarrel with the proposition. What is in dispute here is the applicability of that proposition to the facts of the present case. As discussed above, the transfers in the present case cannot be said to be in contravention of the Articles.

8. No submissions were advanced by learned Counsel for the Appellants on mismanagement under Section 398 of the Act.

9. In that view of the matter, there is no merit in the Company Appeal.

10. As far as the Respondents' cross-objections in the appeal are concerned, the same are on the footing that the CLB has directed the Respondents to give an adequate representation to the Appellants on the board of directors of the first Respondent company. This direction is on the footing that the company is undoubtedly in the nature of a quasi-partnership in which the Appellants claim to be 46.71% shareholders. It is submitted that the purported finding of the company being in the

4 AIR 1997 Supreme Court 1411

5 1986 Company Cases, Vol. 59, page 46

nature of a quasi-partnership has no foundation; that the observation is clearly opposed to the record of the case; that there is no finding concerning the alleged 46.71% shareholding of the Appellants, which is a matter in dispute between the parties; and that the directions for adequate representation is, at any rate, vague and cannot be implemented. The averments that the Respondent company is in the nature of a quasi-partnership are contained in paragraph 5.5 of the original Company Petition. It is the case of the Appellants that the first Respondent company was registered on 26 February 1975 and it took over the business of a partnership firm of Sanjay Founders upon its incorporation. It is submitted that Appellant No.1, Respondent No.3 and Appellant No.4, who was at that time a minor, were partners of Sanjay Founders. It is submitted that, accordingly, Appellant No.1, Respondent No.3 and the late Shankarrao, on behalf of this minor son, were given shares in the first Respondent company. These three persons were the original subscribers, who were allotted one share each at the date of incorporation. It is submitted that this shareholding was continued for sometime and thereafter the paid up capital was increased by allotting shares to close friends of the promoters from time to time upto 1978. It is submitted that the share capital of the Respondent company has remained constant since 1978. It is submitted that all these facts go to show that Respondent No.1 was really in the nature of a quasi-partnership. As against this, the Respondents, in their reply, dispute these averments. It is submitted by the Respondents that at the very first board meeting held three days after the incorporation of Respondent No.1, i.e. on 1 March 1975, two additional shareholders were admitted and they were allotted two shares (one each) out of the total five shares then issued and allotted.

It is submitted that admission of these two members was itself a step in the direction that the promoters/subscribers did not consider Respondent No.1 to be a quasi-partnership. Thereafter, there were several fresh allotments of shares as well as changes in the composition of the board of directors. The Respondents have submitted the particulars of these allotments and changes. There is no serious controversy between the parties on these facts. Thus, the emerging scenario is that immediately after incorporation of the first Respondent company, two new members, who had nothing to do with the erstwhile partnership of Sanjay Founders, were admitted to the membership of the company. The two, thus, held 40% shares in the first Respondent company. So also, four more members were added on 29 June 1978. The position within about three years of the formation of the company was such that, apart from the original subscribers and members of the first Respondent company, there were six other members, who between them held about 938 shares from out of 2811 issued and allotted shares of the first Respondent company. There is nothing in the Articles of Association of the Respondent company to show that the members of the company were to participate in the management of the company. There is nothing to show that the company was formed or continued after its formation on the basis of any personal relationship involving mutual confidence between the shareholders or that there was any agreement or understanding between the shareholders about participation in the conduct of the business of the Respondent company. There is also nothing in the Articles to indicate that there were any restrictions on the transfer of shares, so as to ensure the continuation of the element of mutual confidence between the shareholders. Though there is a clause providing for the right of pre-emption to the existing

members, the clause does not prevent transfers *inter se* between members or between a transferor member and his relations as stipulated in Article 10 of the Articles of Association. These provisions go to show that there is no provision in the articles that the shareholdings of the members were to be in any particular ratio or that an element of mutual confidence was to be maintained between the shareholders. The board of directors of the first Respondent company was changed from time to time and new persons, who had nothing to do with the family of the original subscribers, were made directors. In the light of these facts, which are all borne out by the record of the case and do not admit of any serious controversy, the characteristics of a quasi-partnership are not to be found with respect to the Respondent company. The manner in which the CLB has proceeded to deal with the subject of quasi-partnership also leaves much to be desired. In the first place, in the original order the CLB has observed that the fact that the first Respondent company was in the nature of a quasi-partnership was not a matter of dispute between the parties. After the pleadings in this behalf were pointed out to the CLB, after it passed the original order, the CLB simply substituted the sentence "There is no dispute that Respondent No.1 is a quasi-partnership" by the sentence "The Respondent No.1 company is undoubtedly a quasi-partnership....." The conclusion of the CLB, thus, in respect of the quasi-partnership nature of the company does not bear scrutiny and cannot be sustained. The conclusion is clearly contrary to the record of the case and is arrived at by completely disregarding the admitted record of the case.

11. The directions concerning maintenance of adequate representation of the Appellants on the board of directors are also based

on the extent of shareholding of the Appellants in the first Respondent company. Even this aspect of the matter exhibits a complete non-application of mind and untenable approach on the part of the CLB. As in the case of the finding of a quasi-partnership, so in the case of the extent of shareholding, the original order passed by the CLB observed that the Appellants (i.e. Petitioners before the CLB) held over 46% shares of the Respondent company and that it was on the basis of such shareholding that they were to be given adequate representation on the board of directors of Respondent No.1, but in the corrected order as of 15 November 2010, the CLB simply substituted the sentence "However, keeping in viewwherein the Petitioners hold 46% shares...." by the sentence "However, keeping in view wherein the Petitioners claim to hold more than 46% shares". Such substitution and order based thereon are clearly impermissible. Whether or not the Appellants hold over 46% shareholding in the first Respondent company, is a matter of serious dispute between the parties. In fact, if 536 shares of the first Respondent company are treated as correctly transferred by late Shankarrao to Respondent Nos. 6 to 9, the total shareholding of the Appellants comes to about 26.46%. This appears to have been completely lost sight of by the CLB. The order that an adequate representation be given to the rival group of shareholders first on the basis of a purported finding in the original order and correcting that order later by maintaining the final direction but this time simply on the basis of the rival group's **claim** to hold a certain percentage of shareholding, clearly exhibits a perverse approach.

12. Even otherwise, the direction that an adequate representation should be given to the Appellants without indicating what is meant by such adequate representation is clearly impermissible and cannot be sustained.

13. In that view of the matter, the findings of the CLB and the directions based thereon clearly exhibit errors of law and cannot be sustained, as discussed above. The cross-objections of the Respondents are, accordingly, allowed and the directions of the CLB requiring the Appellants to be given an adequate representation to the Appellants in the management of the business of the first Respondent company as also its finding concerning the Respondent company being a family company in the nature of quasi- partnership, are set aside.

14. In the premises, the following order is passed :

(i) The Company Appeal is dismissed.

(ii) The cross-objections are allowed by setting aside the finding of the CLB about the quasi-partnership nature of the first Respondent company and the directions to the first Respondent company to give an adequate representation to the Appellants in the management of its business.

(iii) There shall be no order as to costs.

15. Learned Counsel for the Respondents continues the statement

recorded in the ad-interim order passed in this appeal on 3 July 2009 for a period of six weeks from today.

(S.C. GUPTE, J.)