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JUDICIAL REVIEW OF INVESTIGATION OF
A COMPANY BY CENTRAL GOVERNMENT

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Twentieth century has witnessed expansion of trade and business enterprise in the corporate form. In India the impact of business companies after the Second World War has been so wide spread that all sections of society have been affected in one way or the other. This has given rise to a concern on the part of legislature to the respective positions, rights and duties of various components of the corporate structure. The functions, rights and obligations of people in the management (particularly directors and now abolished Managing Agents) the shareholders both majority and minority have been defined and regulated both statutorily and judicially. Particularly protection of minority shareholders and the interest of public has been an object of solicitude of legislature and judiciary.

The power of investigation into the affairs of a company vested in the Central Government under Sections 235 to 251 of Indian Companies Act 1956 is one set of provisions to protect interests of minority shareholders and public. The idea of investigation into the affairs of a company suspected of mismanagement and malpractices by a Governmental Agency is not new. As early as 1862 the English Act

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provided for the investigation into the affairs of a Company by Board of Trade in England. The scope and consequences of investigation have increased gradually. Under the present Indian Act of 1956 the scheme of investigation is very extensive with far reaching consequences for the company and people in its management. Concern has been expressed by the Company Law Committee¹ and the judiciary² about the possible abuse of these wide discretionary powers with the Central Government. These wide powers have been vested in the Central Government with a pious hope that they would be judiciously exercised for the bonafide purpose for which they are intended. Wide executive powers like these warrant strict judicial review of administrative actions to prevent their misuse. An attempt has been made in this paper to analyse the provisions of Indian Companies Act 1956 and practice regarding investigation and the scope of review by the Courts.

Investigation by Central Government into the affairs of a Company may be initiated broadly in two ways:-

- (1) At the instance of the members³ Registrar, the court⁵ or company.⁶ The object of these provisions is to enable the members, Registrar or the Company to know what is wrong and who may be held responsible for it in company affairs.

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1. Report of company law committee 1952, p. 133.
 2. New Gen. Jute Mills Co. Ltd. v. Dy. Sec. Ministry of Finance, 1966 Co. Cases 512, 541.
 3. Under Section 235 cl. (a) and (b) on the application of members with minimum prescribed strength.
 4. Under Section 235 sub. cl(c) when Registrar reports under sub-sec. 6 or 7 of Section 234.
 5. Under Section 237 cl.(a) sub.cl. (ii)*
 6. Under Section 237 cl.(a) sub.cl.(i)*
- * In both these cases the Central Government is bound to order investigation.

- (2) Under Section 237 sub.cl.(b) the Central Government is empowered to initiate investigation suo moto without being petitioned by any one. This provision is to protect the interest of indifferent shareholders who may not bother to take steps under Section 235 and also to protect the interest of people dealing with the company who may suffer if the indulgent or even conniving members refuse to initiate proceedings U/S 235.

It is interesting to note that not many investigations have been initiated under Section 235 of Indian Companies Act. Almost all investigations ordered under the Act are under Section 237(b). Further minority shareholders have sought protection under Sections 397, 398 in very large number of cases. This speaks volumes regarding the choice and the faith members have in judiciary and probably the lack of faith in executive. This in itself warrants a stricter judicial review of Governmental investigation of the company affairs.

INVESTIGATION UNDER SECTION 237(b).

Central Government under Section 237(b) of Indian Companies Act has very wide discretion bordering arbitrary power to initiate investigation into the affairs of any company, if it is of the opinion that there are circumstances suggesting any one or more of the following:-

(i) That the business of the company is being conducted with intend to defraud its creditors, members or any other persons, or otherwise for fraudulent or unlawful purpose, or in a manner oppressive of its members, or that the company was formed for any fraudulent or unlawful purpose; or

(ii) that the persons concerned in the formation of the company or the management of its affairs have in connection therewith been guilty of fraud, misfeasance or other misconduct towards the company or towards any of its members; or

(iii) that the members have not been given all the information with respect to its affairs which they might reasonably expect, including information relating to the calculation of the commission payable to a managing or other director, the managing agent, the Secretaries and treasurers, or the manager of the company.

There have been about half a dozen cases before the courts including the Supreme Court where the scope of discretion of the Central Government to order investigation under Section 237(b) has been reviewed. In almost all cases the same individual namely Shree S.P. Jain or his family are the people controlling the company investigated, this may be a coincidence, probably due to the fact that they may have indulged in concerted malpractices. But one gets a lurking doubt that investigation by the Central Government may be a planned persecution of a business house which may have incurred Governmental displeasure, more so when allegations of mala-fide and deliberate harassment are made by the petitioners which have not been convincingly rebutted on behalf of the Government. This creates an apprehension that Governmental discretion to investigate the affairs of a company has great potency of abuse if it has already not been abused. This calls for safeguards to the company by stricter judicial review and suitable statutory amendment without sacrificing the objectives of a genuine investigation. Process of investigation normally starts with a notice to the company which comes as a bolt from the blue informing the company that it is going to be investigated and such and such inspector would do it, because the Central Government is of the opinion that one or more grounds of section 237 (b) are present. The order is a mute and does not disclose the reasons. Then the Company asks for the reasons,⁷ which are refused either on the plea that disclosure would affect investigation adversely or that investigation would discover the reasons. ⁸

7. New Central Jute Mills Co. Ltd., v. Dy. Sec. Ministry of Finance, 1970 Com. Cases 102 at 106

8. Supra. (7).

On such refusal the court is approached with a protest and assertions that the order of investigation is discriminatory, unwarranted, malafide,⁹ intended to harass and damage the company,¹⁰ with citations of facts showing that the company is well managed and none of the possible grounds under Section 237(b)(1)(ii)(iii) are present.

Central Government has opposed these petitions with a stock answer that the discretion of the Government under Section 237(b) of the Act is subjective and absolute and therefore cannot be questioned in a court of law either for reasons of constitutionality under Art. 14 or Art. 19(1)(g) of the Indian Constitution or otherwise. As regards the constitutionality the Supreme Court has held in *Barium Chemicals v. Company Law Board*¹¹ that the exercise of power to investigate under Section 237(b) of the Companies Act 1956 does not violate Art. 14 nor it can be challenged under Art. 19(1)(g) of the Constitution as protection of this Article is not available to a company as held in *State Trading Corporation of India Ltd. v. Commercial Trading Tax Officers Vishakapatnam*.¹² Even otherwise according to Justice Hidayatulla, Justice Bachawat and Justice Shelat,¹³ it is not unconstitutional as it amounts to reasonable restrictions permitted by the Constitution.

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9. *Barium Chemicals v. Company Law Board*, 1966 Co. cases 639.
 10. *Dy. Sec. Ministry of Finance v. Sahu Jain Ltd.* 1970 Co. cases 83 at p. 90.
 11. 1966 Company cases 639.
 12. 1963 Company cases 1057.
 13. In *Barium Chemicals v. Company Law Board* 1966 Company Cases 639.

However, the discretion is not absolute as the analysis of Section 237(b) would show that that investigation of a company under this provision is subject to two pre-conditions. Firstly, the Central Government (Now the Company Law Board) should be of the opinion that the particular company needs investigation. Secondly, that this opinion is for reasons of suggestive circumstances that one or more grounds of Section 237(b)(i)(ii)(iii) are present. The formation of the opinion by the Government is obviously a subjective process and is, therefore, not open to judicial review as explained by Justice Shelat in Barium Chemicals, "There can be no doubt that the legislature provided for the opinion of the Government and not of a court." Therefore, it cannot be questioned either for sufficiency or reasonableness in a court of law provided of course the opinion is formed in a bonafide manner. Thus this action is discretionary and administrative limiting the judicial review to only two situations namely (a) When the Central Government had not formed the opinion at all or (b) when the opinion formation was mala-fide or preverse because no suggestive circumstances for the formation of opinion to investigate were known to the Government at the time of decision to investigate the affairs of a company. A natural corollary of this is that if irrelevant or extraneous circumstances are the basis of the opinion, the opinion formation process is not valid. Further as rightly held in New Central Jute Mills Co. Ltd. v. Dy. Sec. Ministry of Finance¹⁴ circumstances discovered after investigation cannot validate the opinion formation in retrospect.

Scope of judicial review is available for governmental action as the legislature expressly mentions suggestive circumstances in the Section. Fortunately the Supreme Court of India has taken the right step in Barium Chemicals v. Company Law Board¹⁵ in extending the scope of judicial review to the scrutiny of suggestive circumstances which in this case were delay in completion of project and losses. Similarly, in Rohtas Industries Ltd. v. S.D. Aggarwal¹⁶ the purchase of convertible preference

14. 1970 Company Cases 102.

15. 1966 Company Cases 639.

16. 1969 Company Cases 781.

shares apparently at the market rate and the fact of reputation of Shri S.P. Jain due to Bose Commission report and pending prosecution were held to be irrelevant and extraneous for the formation of opinion by an expert body like Company Law Board. As not even a prima facie conclusion can ever be drawn from these circumstances that fraud of mismanagement is being practiced. Thus the court has found a foothold to prevent a perverse exercise of discretion.

This attempt on the part of the judiciary to probe opinion formation has been resisted by the Central Government by insisting that not only the opinion but also the suggestive circumstances on which such opinion is formed, is subjective and, therefore, out of the scope of judicial review. To quote Mr. Justice Mitra in *Dy. Sec. Ministry of Finance v. Sahu Jain Ltd.*,¹⁷ "They draw a tight veil around them and think the veil can neither be pierced nor lifted." It is inconceivable that legislature did not intend this little protection. 18 Instances have been given by the Government where emergency provision having phrases like, "in the opinion" or "satisfaction" of an administrator, action may be taken and the basis of such opinion or satisfaction could not be questioned in court of law. 19 It is to be noted that firstly Section 237(b) is not an emergency provision like Defence of India Rules which are class in themselves with a different purpose and secondly even in such cases, in absence of any ground suggesting the exercise of discretion, judicial review is possible. 20.

The courts have however agreed that reasons or the suggestive circumstances need not be cited or disclosed to the company at the time of ordering investigation. But once they are challenged (as is always the case), then the reasons must be disclosed to the court, ²¹ a blanket of denials in affidavit is not enough. The practice of the Central Government not to disclose any reasons to the company (which has judicial approval) is to say the least unfair to the company which is taken by surprise; In any case it

17. 1970 Company Cases 83.
18. Shelat J. in *Barium Chemicals v. Co. Law Board.*
19. *Sadhu Singh v. Delhi Administration* AIR 1966 SC 91,
20. *Emperor v. Shibnath Banerjee* 1944 F.C.R. 145 P.C.
21. *New Cent. Jute Mills v. Dy. Sec. Ministry of Finance* 1966 Co. cases 572.

leads to litigation and delay in all cases as the order is challenged always to seek disclosure of circumstances before the court. They delay frustrates the investigation and harms the company in its business and reputation. It would be, therefore, better if the reasons are given in the order of investigation which should be a speaking order as far as possible. The argument that disclosure in advance is likely to affect investigation is a disguise either for perverse exercise of power or an excuse for a "fishing expedition". The powers of enquiry vested in the inspector²² are so wide that the disclosure of reasons is not likely to effect the investigation in any material sense.

NATURE OF DUTY OF AN INSPECTOR:

One of the fundamental questions in case of judicial review of investigation of a company by central government has been whether an inspector appointed by the Government to make investigation into the affairs of a declared company is under a duty to act judicially? Or to use the well known expression of Lord Atkin in *R. v. Electric Commissioner*,²³ whether the inspector during company investigation is a person "having legal authority to determine questions affecting the rights of subjects and having duty to act judicially."

The answer has been in negative ever since the famous case of *Re Grosvenor and West End Railway Terminus Hotel Co. Ltd.*,²⁴ This case has been approved and followed in England,²⁵ Australia²⁶ and India.²⁷ The reasons that an inspector does not discharge a judicial-duty are, because he decides nothing,²⁸

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22. Discussed later.
 23. (1924) 1 K.B. 171.
 24. (1897) 76, L.T. 337 (a case on English Act, Ss. 56-61 similar to our own provisions).
 25. *Hearts of Oak Assurance Company Ltd. v. A.G.* 1932, A.C. 392.
 26. *R. v. Coppel; Ex parte Viney Industries* (1962) V.R. 630.
 27. *New Gen. Jute Mills Co. v. Dy. Sec. Ministry of Finance* 1959 Co. cases 97 at 111. *Cocmpatore Spinning and Weaving Co. v. Srinivason* 1966 Co. cases 572.
 28. *New Gen. Jute Mills Co. Ltd.* 1966 Co. cases 512, 535.

his report is not a judgment. His job at best is that of a fact finding commission.³⁰ Investigation by an inspector has been compared with a police enquiry³¹ or an enquiry by a Revenue Officer. For all these reasons the proceedings before an investigating inspector are treated neither judicial nor quasi judicial.

Time and again the test of judicial or administrative nature of a statutory body (an inspector is one) has been based on the dual principles laid down by Lord Atkin in the passage quoted above. Firstly the person should have legal authority to determine questions affecting rights of subjects. It is to be noted that it would be difficult to classify an enquiry as judicial unless it directly affects a person, the indirect effects to others (as is true for the company and people in its management) may be dire, but this does not alter the nature of the proceedings. Secondly, the process by which the person functions must be a judicial process as explained by Lord Radcliff in *Nakhuda Ali v. M.F. De S Jayratne*,³² "In truth the only relevant criterion by English Law is not the general status of the person or body of persons by whom the impaired decision is made but the nature of the process by which he or they are empowered to arrive at their decision. When it is a judicial process or process analogous to the judicial, certiorari can be granted". Thus the duty to act judicially arise if the process to be followed is either judicial or analogous to judicial process.

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29. *Ramiah Nadar v. Amrithraj* 1962 Co. cases 52.
 30. *Raja Narayan Bansilal v. Manech Phiroz Mistry* 1960 Co. cases 644 (Supreme Court Spoke in this case for inspector under Section 234-235 and not under Section 237).
 31. 1959 Co. cases 97 (the analogy is rather misplaced).
 32. (1951) A.C. 66.

Let us examine the procedure of investigation and the powers of the inspector appointed by Central Government to investigate the affairs of a company under Sections 235-237 of the Act of 1956. The Act significantly mentions nothing about the procedure to be followed by the inspector though his wide powers are enumerated (which have been extended more than once by amendment). The inspector can call a host of people³³ in the management or employment of the company and even outsider to appear before him as witnesses and testify, the latter with prior-permission of the Central Government.³⁴ The examination of these witnesses may be on oath and their testimony may be reduced into writing and their signature obtained on the testimony. Other powers of the inspector include probing of allied companies, seizure of documents and power to prosecute persons refusing to answer questions or producing documents required by him. The powers and procedure may not be judicial in the conventional sense as put by the Madras High Court in *Coimbatore Spinning and Weaving Mills v. Srinivasan*³⁵ as the Central Government is not in a position of a plaintiff or complainant before him, there is no cross examination of witnesses. But the procedure is not completely devoid of judicial tinge also. It may be classified as analogous to judicial proceedings.

Section 246 of the Act of 1956 provides that copy of the report of inspector appointed under Sections 235-237 is admissible in any legal proceedings as evidence of the opinion of the inspector in relation to any matter contained in the report. Central Government may decide to petition for compulsory winding up for justice and equity or may decide to prosecute persons for their misdeeds or both on the basis of the report under-Section 243.

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33. Section 240 of the Act.
 34. Section 240 of the Act.
 35. 1959 Co. cases 97 at 111.

Since the report is an expression of opinion, or at best a recommendation to the Central Government, which may accept or reject it, the conventional view, therefore, is that inspector or his report does not affect the rights of the subjects in Lord Atkins language. However, the report is not that innocuous, as great reliance is likely to be placed by the Central Government to take action under Section 243 on its basis and therefore, it does affect the rights of the company. The argument that effects are indirect is more sophisticated than real. Further the evidentiary value of the report can hardly be underestimated as indicated by two recent cases Re. S.B.A. Properties Ltd.³⁷ and in Re Travel and Holiday Club Ltd.³⁸ where it has been held by Pennycuik J. that the report is a material on which if unchallenged, the court could make an order of winding up. Thus report of the inspector does lead to extremely serious consequences, while the company or the witnesses before the inspector cannot claim even the assistance of a counsel³⁹ at the time when investigation is going on to prevent distortion of the report by default on the part of the witnesses.

Irrespective of the nature of the Inspectors functions which may not be called judicial or quasi judicial in the conventional sense, in fairness it is desirable that the principles of natural justice should be made applicable for proceedings before the Inspector to mitigate the hardship of the company and its managers. The argument that judicial scrutiny is there at the time of prosecution or petition for winding up overlooks the burden of proof at a later stage when a prima facie case seems to be there on the basis of report. Application of principles of natural justice to proceedings before the inspector should not be difficult in view of Supreme Courts remarks in a very recent case A.K. Kraipak and others v. Union of India⁴⁰ Mr. Justice Hegde observed "the

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- 36. In a recent case Re. ABC Coupler Engineering Co. (1962) 3 A.L.R. 68 it has been held that report by itself cannot be admitted as proving the facts contained therein.
 - 37. 1967 Com. cases 618.
 - 38. 1967 Com.cases 673.
 - 39. Significantly English Act does provide in Section 167 for assistance of counsel to outsiders. Our Act is silent.
 - 40. A.I.R. 1970 S.C. 150.

horizon of natural justice is constantly expanding". He further adds "the aim of rules of natural justice is to secure justice or to put it negatively to prevent miscarriage of justice. These rules can operate only in areas not covered by law. On page 157 he adds "till very recently it was the opinion of the courts that unless the authority concerned was required by law under which it functioned to act judicially there was no room for the application of rules of natural justice.... If the purpose of rules of natural justice is to prevent miscarriage of justice one fails to see why these rules should be made inapplicable to administrative enquiries." From these observations the distinction between judicial and administrative bodies seems to be disappearing. It is hoped that for practical difficulties faced in company investigation the procedure before the inspector shall be covered by principle of natural justice and some sort of limited judicial review would be possible.

PROCEEDINGS BEFORE THE INSPECTOR AND ARTICLE 20(3) OF THE CONSTITUTION:

An allied issue with the nature of inspector's functions is whether in such enquiry a person can refuse to answer incriminatory questions and seek protection of constitutional guarantee under Art. 20(3) of Indian Constitution. Supreme Court in Raja Narayan Bansilal v. Maneck Phiroz Mistri⁴² after review of cases⁴³ held that Constitutional guarantee under Art. 20(3) is available to a person only when a formal accusation has been made against him relating to an offence which in the normal course may result in prosecution. Gajendragadkar J. observed that investigation carried on by an inspector is like that of a fact finding commission. In such a case there is no accusation either formal or otherwise against any one. The constitution comes into operation only when a person is accused of an offence and is compelled to give evidence and not when a person is

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41. A.I.R. 1970 S.C. 150, at page 156.
 42. 1960 Company Cases 644.
 43. Magbool Hussain v. State of Bombay (A.I.R. 1953 S.C.J. 456, Shorma v. Satish Chandra 1954 (S.C.J. 428) Thomas Dona v. State of Punjab 1959 S.C.J. 699, etc.

compelled to give evidence on the basis of which he may be accused later. The issue of an already accused person against whom the prosecution was pending came in *Shushil Kumar Sanghi v. R.R. Kini*,⁴⁴ where Mr. Sanghi refused to answer questions during investigation on the plea that replies are likely to incriminate him in a pending prosecution before the District Magistrate regarding criminal breach of trust. Punjab High Court rejected the plea for reasons of vagueness. In any case, refusal to answer a question having direct bearing on facts about which a prosecution is already pending against a person, has to be protected. Though no blanket protection is possible nor is desirable as it would otherwise frustrate the object of enquiries, at the same time constitutional guarantee under Art. 20(3) should be liberally extended. This again calls for assistance of a lawyer to inform the witness of the incriminating nature of the question at the investigation stage, to reduce the chances of incriminatory questions being replied and such testimony being used against the witness in pending prosecution.

CONCLUSIONS:

1. The order of investigation from the Central Government should be a speaking order disclosing reasons for investigation.
2. Since the consequences of the report of the inspector are so serious and far reaching in fact (though not in law) the procedure before the inspector should be subject to principles of natural justice.
3. Constitutional guarantee of Art. 20(3) should be liberally available during the investigation by the inspector.
4. The practice of company law board of appointing inspectors from within the Department though technically unobjectionable as any one can be appointed as inspector under the Act is not very desirable. It would be better if outside experts are appointed to investigate the affairs of the company. This would meet the criticism made in some cases that inspectors are biased as they come with a sense of commitment to definitely, find something objectionable to justify the order of investigation of their department.

44. 1965 2 Comp. L.J. 311.

