

INDIAN LAW INSTITUTE, NEW DELHI

Seminar

On

Company Law

May 1970

GOVERNMENTAL INVESTIGATION OF COMPANY AFFAIRS

By

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The twentieth century phenomenon of the growth of companies in number as well as strength and potentiality has been a matter of far reaching significance. It has not only established the supremacy of corporate business over individual trader, who has been to a great extent ousted by large impersonal corporations, but has also presented varied problems of relationship between the state and the company on the one hand, and the company and the citizens on the other.

Company, as collection of individuals for the common object of commerce, bestows innumerable advantages on its members.<sup>1</sup> But there also arise situations when the collective power works to the detriment of some members; and with all collective energy at its command, the company proves too strong a contender for the individual. Such situation calls for State interference—a essential and proved technique of Collectivist philosophy. The rationale of state interference is very aptly explained in a observation of J.S.Mill thusly. "When any power has been made the strongest power enough has been done for it, care is therefore wanted to prevent that strongest power from swallowing up all others."<sup>2</sup> The protective hand of the state takes the form of various legislative measures, relating to company administration.

The appreciation of the possibilities of clash between group interest and individual interest has served the justification for a variety of company law measures which in effect afford protection to the individual members

against the company.<sup>3</sup> Measures relating to fraud on minority, mismanagement of company affairs, oppression of minority, and investigation of company affairs are notable for their object of protecting individual shareholders or other members of the public in their dealings with the company. Presently, we shall confine our discussion to investigation of company affairs by the Government.

In the sphere of companies twentieth century witnessed a double movement. On the one hand there was all round growth of corporate power. On the other hand, there occurred enormous increase in the state control over corporate affairs. Referring to this trend in the light of investigation and inspection by state, one finds that there has been a uniform increase in the powers of investigation etc. in all modern company legislations.<sup>4</sup> The device of investigation or inspection presents a opportunity to the state to peep into the company affairs and also regulate them. Thus investigation amounts to a in-road into the companies right of managing its affairs free from external interference. Such a invasion of the right of the company is done in the interest of the individual who lacks knowledge, inclination and means to protect himself. Investigation protects the individual in the following two ways:-

(1) It might lead to further disclosure of information regarding the company which gives the individual a better knowledge of the affairs of the company.<sup>2</sup> It might prove as an alternative remedy for oppression or mismanagement etc.<sup>5</sup>

### Investigation under the Indian Companies Law

Sections 235 to 251 deal with different aspects of investigation and Inspection under the Indian companies Act, 1956. Sections 235 and 237 enumerate the conditions required for ordering investigation. These sections mention central Government as the sole authority in all matters of investigation., But the Central Government has to take a decision regarding investigation in accordance to certain formalities required under sections 235 and 237. Thus, the central Government can order for investigation only after receiving either, (a) an application of the members or a report by the Registrar for investigation<sup>6</sup> or (b) in the event of a declaration passed by special resolution of the company or the court, or (c) where in the opinion of the Central Government there are circumstances justifying investigation. Under category (a) and (b) the Central Government only orders and directs the mode

of investigation, after it has received either the application report or a declaration for investigation. Thus under such situations the central Government only carries into effect the opinion already formed by some other body. Keeping in view the facts, that the Central Government knows little about the internal affairs of the company and it only acts on behalf of interested parties, the requirement of application, report or declaration makes the process of investigation effective and just. It also protects the company against unwanted invasion by the Central Government itself.

### Section 237 (b)

Under this section wide and exclusive powers of investigation are given to the Central Government. Here the Central Government, not only orders investigation on the basis of the opinion of some other body, but has to form its own opinion also. This brings together both the powers of forming opinion and ordering investigation in the hands of Central Government. Such a concentration of power in the hands of one authority raises the possibilities of misuse of power to the detriment of the company. But in view of certain built checks under section 237(b) and the technique of judicial review, this power is kept within just limits.

On analysis of section 237 (b) we find that the power of the central government is subject to the existence of either of the following circumstances:-

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

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

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

The enumeration of these circumstances serves as a hedging device against government's wide discretionary powers. Justice Hidayatullah explained those circumstances as checks in the following words "An action not based on circumstances suggesting an inference of the enumerated kind will not be valid. In other words the enumeration of the inference which may be drawn from the circumstances, postulates the absence of a general discretion to go on a fishing expedition to find evidence."<sup>10</sup>

Emphasising the significance of these circumstances justice Mudholkar (Speaking for himself and Sarkar C.J.) observed in Barium Chemicals case". The words "in the opinion of "govern the words "there are circumstances suggesting" and not the words may do so. The words 'circumstances and' suggesting cannot be dissociated without making it impossible for the board to form an opinion at all.

Therefore in the exercise of power under 237(b) the discretion is limited to a great extent on account of the presence of enumerated circumstances.

The nature of Central Government's power under section 237 (b) has also attracted judicial attention which has been helpful in a better understanding of the whole issue. The Supreme Court in Barium Chemical's case, and, Rohtas Industries case,<sup>12</sup> the opinion forming power as a discretionary power of the central Government.<sup>13</sup> But in both the above cases the court made this power subject to judicial review.<sup>14</sup> The issue of nature of discretionary power under section 237 (b) was raised in Rustom Cavasjee Cooper v. Union of India (Bank Nationalisation case)<sup>15</sup> where it was held by Shah C.J. that what is open to judicial review is the existence of circumstances but not the opinion of the Government.<sup>16</sup> It was further held that in both Barium Chemicals case and Rohtas Industries there was no sufficient material for forming the opinion.

### Constitutionality of Investigation

Provisions dealing with investigation have also been attacked on constitutional grounds. Since every investigation amounts to invasion on the rights of the company or incidentally the rights of the shareholders who compose it, therefore testing these provisions and the pursuant actions on the constitutional touchstone is invoking greater interest.

In Barium chemicals case<sup>17</sup> one of the grounds for challenging the order of the Board through a writ of mandamus under article 226 of the Constitution, was that the provisions of section 237 (b) are void as offending Article 14 and 19 (1) (g) of the Constitution. Expressing their opinion on this point the Supreme Court (speaking through Sarker C.J., Mudholkar J. and Hidayatullah J.) held that firstly, a company being a artificial legal person cannot claim fundamental rights under articles 14 and 19 of the constitution, secondly, even assuming that 237 (b) imposes restrictions on right of property or right to carry on occupation of a citizen, those restrictions are reasonable and are imposed in the interest of the general public.<sup>18</sup>

Constitutionality of the provisions dealing with investigation was challenged in Rohtas Industries case also. The following observation of Hegde J. is very pertinent in this regards. "In interpreting section 237(b) we cannot ignore the adverse effect of the intervention on the company. Finally we must also remember that the section in question is an inroad on the powers of the company to carry on its trade or business and thereby an infraction of the fundamental rights guaranteed to its shareholders under art.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 the general public."<sup>19</sup>

The above observation increases the possibilities of instances where investigation might be held as a unreasonable restriction and therefore unconstitutional.

Thus the purely collectivistic technique of investigation which gave wide powers of interfering with company affairs to the government comes under strict judicial scrutiny. The judicial attitude shows little favour for governmental interference. In Barim chemicals case, and Rohtas Industries case the investigation was held to be unwarranted for want of circumstances justifying it. In Rohtas Industries case investigation was further considered as a invasion of the right of the shareholder, therefore, exposing it for more to the requirement of constitutionality than ever. The existing judicial attitude might be justified from the point of view of individual rights,<sup>20</sup> but it certainly amounts to curtailment of Governmental power of control and regulation of the company affairs. Governmental control and regulation being a essential feature of welfare State shall have to be accepted and recognised till such time when Welfare State role of the Government is not needed.

