

Investigation (Sections 235 – 251)

Investigation of company's affairs in other cases (Section 237)

Question 1

A majority of the Board of Directors of M/s High Value Infotech Ltd. have realised that some of the business activities carried out in the name of the company are not in the interest of either the company or its members. They want that the company should make an application to the Central Government to appoint an Inspector to carry out and so as to find out the whole truth. Explain the steps that should be taken to achieve the purpose and draft the application.

(November, 2001, May 2005, May 2007)

Answer

According to Section 237 of the Companies Act, 1956 the Central Government shall appoint one or more persons as inspectors to investigate the affairs of the company if the company by a special resolution or the court by an order declares that the affairs of the company should be investigated. The Central Government may also appoint an inspector if in the opinion of the Company Law Board, there are circumstances suggesting that:

- (i) the business of the company is being conducted with intent to defraud creditors, members or any other persons.
- (ii) the persons concerned in the formation of the company or the management of its affairs have been guilty of fraud, misfeasance or misconduct towards the company or its members.
- (iii) the members have not been given all information with respect to its affairs.

Thus the directors of High Value Infotech Ltd have three options before them to get the company's affairs investigated. Firstly, they can get a special resolution passed in a general meeting of the company. Secondly they can approach the court with a petition so that the court directs the Central Government to order investigation. The directors can also approach the Company Law Board with a petition. However, the Central Government may order an investigation on the recommendation of the Company Law Board. Thus the Central Government has a discretionary power in the last case; whereas in the first two instances the Central Government has no such discretion and it has to order the investigation.

Draft Application:

High Value InfoTech Ltd. (Address)
Dated 1st April, 2001

The Secretary,
Department of Company Law Affairs,
New Delhi

Sir,

At a meeting of the shareholders of the company, the members have passed the following special resolution unanimously:

“Resolved that the Central Government be approached to appoint an Inspector to carry out an investigation whether the following activities carried out in the name of the Company is or is not in the interest of either the company or its members.

“(Name a couple of activities)”

The said unanimous resolution was passed at an extraordinary general meeting of the Company held on 10th March, 2001.

It is, therefore, prayed that the Central Government be pleased to appoint as per Section 237 of the Companies Act an inspector to investigate the affairs of the company regarding the matters mentioned in the above resolution and communicate its decision to the company.

Yours respectfully,

For and on behalf of High Value InfoTech Ltd.

Secretary.

Proceedings for recovery of damages or property (Section 244)

Question 2

The report submitted by the inspector appointed under Section 235/237 of the Companies Act, 1956 to investigate the affairs of a Company revealed that substantial funds of the Company have been misappropriated by the Managing Director of the Company. The Central Government is of the opinion that effective action may not be taken the company for recovery of the funds misappropriated by the Managing Director. Examine with reference to the provisions of the Companies Act, 1956 the action that can be taken by the Central Government for recovery of damages or funds misappropriated by the Managing Director.
(November 2009)

Answer

Section 244 of the Companies Act, 1956 provides that where from the inspectors' report it appears that a fraud or misappropriation of property has been committed and the Company is therefore, entitled to bring an action for damages for misconduct or for the recovery of any property, which has been misapplied or wrongfully retained, the Central Government may itself

5.3 Corporate and Allied Laws

in public interest bring proceedings for that purpose in the name of the Company. Thus, the Central Government is empowered to bring civil proceedings in the name of the Company in any case where it appears that such proceedings ought in the public interest to be brought, even if the company does not take such action. In such a proceeding, the inspector's report shall be admissible as evidence of the opinion of the inspection in relation to any matter contained in the report (Section 246). The Central Government should indemnify the company against any cost or expenses incurred by it or in connection with any proceedings brought by it. [Section 244 (2)].

Imposition of restrictions upon shares and debentures and prohibition of transfer of shares or debentures in certain cases (Section 250)

Question 3

ABC Limited, over years, enjoys high reputation and its General Reserve is many times more than the paid up capital of the company. There is apprehension of cornering the shares of the company by some persons likely to result in change in the Board of Directors which may be prejudicial to the Public interest.

Advise, as to how can ABC Limited block the transfer of shares of the company under the provisions of the Companies Act, 1956. (May 2008, CA Final, New Course, May 2010)

Answer

Restrictions and Prohibition of transfer of shares or debentures: As per provisions of section 250(4) of the Companies Act, 1956, where the company Law Tribunal (Company Law Board till the Company Law Tribunal becomes operational, referred to as CLB hereinafter) has reasonable grounds to believe that a transfer of shares in a company is likely to take place whereby a change in the composition of the Board of Directors of a company is likely to take place and the CLB is of the opinion that any such change would be prejudicial to the public interest, the CLB may, by an order, direct that any transfer of shares in the concerned company during such period not exceeding three years, as may be specified in the order, shall be void.

As per section 250 (1) & (2) of the Companies Act, 1956, if the CLB is of the view that there are good reasons to find out the relevant facts about any shares and the CLB is of the opinion that such facts cannot be found out unless the restrictions are imposed, as an interim measure, it may, by an order, direct that transfer of any such shares shall be void and no voting rights shall be exercised in respect of such shares. However, the CLB is empowered to vary or rescind its order any time.

The facts given in the question squarely fall within the provisions of section 250 of the Companies Act, 1956. The management of ABC Ltd. may make a complaint to the CLB and convince it that the transfer of shares in favour of the group of unscrupulous persons would change the composition of the Board of Directors of the company which shall be prejudicial to the public interest and if the CLB is convinced with the plea of the company, it may pass an order as stated above which would block the transfer of shares as stated in the question.