Hanuman Prasad Bagri Vs Bagrees Cereals (P) Ltd.

Court: Calcutta High Court

Date of Decision: Feb. 22, 2007

Citation: (2007) 138 CompCas 542 : (2009) 2 CompLJ 237

Hon'ble Judges: Kalyan Jyoti Sengupta, J

Bench: Single Bench

Judgement

Kalyan Jyoti Sengupta, J.
The above motion has been taken out by the Plaintiffs for the following interlocutory reliefs:

(a) Defendants Nos. 1 to 4 are restrained from acting upon or giving any effect or further effect to the said purported letter dated 7 February

2005, contained in annexure D hereto or from issuing or allotting any further share in the defendant-company until disposal of the suit;

(b) Injunction restraining Defendants Nos. 1 to 4 either by themselves or through their servants, agents, assigns or howsoever otherwise from

taking any step for diminishing or decreasing the shareholdings of the Petitioners in the Defendant company being 18.26 per cent, of the total

issued, subscribed and paid-up share capital of the Defendant company in any manner whatsoever.

2. Going by the petition being grounds of the notice of motion the grievance of the Petitioners is against the decision of the board of directors to

issue-rights shares and further against any future attempt or action to increase or decrease the share capital aiming to disturb the pattern of

shareholding of the existing shareholders. Though in the plaint, various reliefs have been claimed, however, at the present moment I am not

concerned with the same. The sum and substance of the case of the Petitioners is that going by the financial position and the activities of the

company there was no need to increase the share capital by issuance of rights shares. From the balance sheet it will appear that Defendant No. 1

has sufficient surplus funds, which can be utilised for expansion of the business. The whole idea to increase share capital is to decrease the

percentage of the Plaintiffs/Petitioners so much so that the existing directors can retain their absolute control as long as possible. There are other

allegations hinting at mismanagement and misappropriation of fund without any check and balance. The extravagant expenditure of the directors

has led to deprivation of the Defendant and existing shareholders for a long time. In sum and substance, the decision to issue rights shareholding is

not bona fide and has abused the fiduciary power of the directors.

3. Mr. S. Sarkar, learned senior advocate, appearing in support of the motion, while inviting my attention to the balance-sheet and the audit report,

submits that the company has enough funds and in fact the fund has been diverted by granting loan to various third parties which could be

recovered and be utilised to expand the business. He further submits that the real business activity of Defendant No. 1 has been stopped long time

back. Now the business activity is confined to letting out of the godowns and premises of the company and the incomes therefrom are the main

source. As such there is no need to increase further share capital. Moreover, there is no detailed project or scheme as to how the increased share

capital will be utilised and despite having sufficient funds in the hands of the company why further fund is required. Therefore, the decision of the

directors to issue rights shares to the existing shareholders without any right of renouncement of any share is nothing but to marginalise the

Petitioners who have a considerable extent of shareholding. In view of the absence of right of renouncement the unsubscribed shares might be

issued to the chosen persons of the directors so that in the office of the board they can perpetuate and mismanage as long as possible. According

to him, the aforesaid fact demonstrate amply the lack of bona fides. In support of his contention he has relied on an old English decision reported in

Piercy v. S. Mills and Company Ltd. (1920) 1 Ch. D 77.

4. Mr. N.K. Podder, learned senior advocate, while resisting this application, submits first that unless there is proof that the decision of the board

of directors is mala fide none of the shareholders can make any complaint against such decision as under the statute the board of directors has

been given fiduciary power and ample discretion for the interest of lawful running of the company. He says that up to 1989, the manufacturing

business of the company was carried on smoothly. However, due to change of Government policy and non-availability of raw materials the

manufacturing activity was not found to be profitable as a result I whereof the same had to be stopped. Thereafter the godowns, factory premises

and other houses of the company were let out on a rental basis to the various intending parties. With this diversified business activity the company

has some how survived. The dividend of the company was not given for the benefit of the company and to tide over the accumulated loss. While

carrying on the business of letting out it was found that there is good prospect if this business is modernised.

5. For the sake of modernisation of the business some additional funds are required; as such; it has been decided without initially approaching third

party that certain amount of fund can be generated by issuing rights shares on the basis of 1:2 ratio. Therefore, all the existing shareholders will

have a chance to subscribe to these rights issues and with this process it is expected that a sum of Rs. 20 lakhs can be mopped up. It is true that

there are funds in the hands of the company for granting loan to the parties but this cannot be utilised as loan as the company is receiving fixed

income from it by way of interest. How the company can be effectively run with profit is the absolute domain and discretion of the board cu

directors.

6. He has drawn my attention to various paragraphs in affidavit-in-opposition and submits that the object to issue rights shares is neither mala fide

nor for personal interest of the directors. He, on the other hand, complains that all the time those Petitioners/Plaintiffs have made attempt to disturb

the company''s running in every possible way by filing frivolous litigation after litigation and with this process the company''s fund is depleted to a

great extent. The present suit and connected applications are such instances. The law court hardly interferes with the decision of the board of

directors who enjoy the power as provided in the Act itself and this power should not be interfered with even if the decision in some cases may

change the shareholding pattern and may render the majority shareholders into minority. Nonetheless the approach of the court is to examine as to

whether there has been mala fide action to subserve the individual and personal interest of the directors or not. In this connection he has relied on a

decision of the Supreme Court reported in the case of Needle Industries (India) Ltd. and Others Vs. Needle Industries Newey (India) Holding

Ltd. and Others, , particularly paragraph 111. He further submits that this Plaintiffs'' group made attempt earlier by filing frivolous proceedings u/s

397 and the same was dismissed with an observation of the court that the Plaintiffs'' intention is to grab money and money alone. He has brought

this decision for drawing my attention to the Jetu Jacques Taru Lalvani and another Vs. J.B.A. Printing Inks Limited and others, .

7. It is appropriate to record that at the initial stage on 25 February 2005, I passed an order that at the ad interim stage observing that the increase

of share capital may not be necessary as it is sought to be done by issuance of fresh equity shares but the actual picture will come up when the

affidavits will be filed. However, I did not grant any order of injunction restraining the Respondents to issue shares to increase the share capital. But

I made it clear that the Plaintiffs would be at liberty to subscribe to the shares in accordance with the rules as permissible that will be without

prejudice and all the decisions shall be abided by the result of this application. Now, at this stage, the question is after having affidavits whether the

aforesaid interim order should be continued or further interim order is required to be passed or this interim order with rider will be vacated or not.

8. After hearing at length and considering the position of law it appears to me that the decision of the board of directors in the matter of increase of

share capital by way of issuing rights shares has to be for the interest of the company. If it is established that only for the benefit of the company

increase of share capital is required, by any means such decision cannot be interfered with under any circumstances even if it changes the

shareholding pattern or for that matter the majority shareholders are reduced to minority one. The Supreme Court in its decision cited by Mr.

Podder has dealt with this position of law exhaustively after considering large number of English decisions including the decision cited by Mr Sarkar

reported in Piercy v. S. Mills and Company Ltd. (1920) 1 Ch D 77.

9. I think before I deal with Mr. Sarkar''s citation 1 prefer to consider our Supreme Court decision on this subject. In paragraph 111 in the case of

Needle Industries (India) Ltd. and Others Vs. Needle Industries Newey (India) Holding Ltd. and Others, the three judge Bench of the Supreme

Court concluded the petition of law in this issue as follows:

Whether one looks at the matter from the point of view expressed by this Court in Nanalal Zaver and Another Vs. Bombay Life Assurance Co.

Ltd. and Others, or from the point of view expressed by the Privy Council in Howard Smith Ltd. v. Ampol Petroleum Ltd. (1974) AC 821, the

test is the same, namely, whether the issue of shares is simply or solely for the benefit of the directors. If the shares are issued in the larger interest

of the company, the decision to issue shares cannot be struck down on the ground that it has incidentally benefited the directors in their capacity as

shareholders. We must, therefore, reject Shri Seervai''s argument that in the instant case, the board of directors abused its fiduciary power in

deciding upon the issue of rights shares.

10. Therefore, their Lordships have discussed and summarised all the decisions oh various courts, viz., English courts, Australian courts as well as

Canadian courts and also the Privy Council and, lastly, the earlier decision of the Supreme Court and thereafter the aforesaid principle of law have

been deduced.

11. I do not find any other authorities or provision of the law apart from what has been stated. As such I respectfully follow the aforesaid principle.

12. Whether it is the interest of the company or bona fide or not can only be ascertained from each and individual set of facts. Mere allegation of

mala fides or absence of bona fides will not do. It needs more than mere averment, rather proof. In the case in hand I find that the company has

answered to the charges of abuse of fiduciary power of the directors. It is stated on oath that letting out of business appears to be very profitable

and is having a greater prospect. As such, it has been decided to issue shares to generate funds in every possible way. I am of the view that merely

surplus funds are available in the file of the company and there is no need to generate further funds is not always viewed as being a mala fide one. It

is a discretion or the power of the directors in which way the company should, be run as their act and activities are reflected in the accounts,

balance-sheets and in the annual general report and in the annual general meeting of all the shareholders. Rigorous provision of law is there to keep

an eye and to make a check and balance of the action being taken by the board of directors.

13. The application of the petitioned is that by issue of the rights shares the shareholding pattern or extent of shareholding of the Petitioners would

be reduced. In my view there is no basis of such apprehension because a decision has been taken that one rights share would be issued as against

two existing shares. So, if this is distributed amongst all the shareholders as it appears from the notice then the position of the shareholding or extent

of the same will not be changed unless, of course, the Plaintiff does not opt to reduce the same. But one thing remains as it has been stated in the

notice, that there is no right of renouncement. In the absence of the same there may be a chance of the allotment of unsubscribed shares by the

existing shareholders to other persons.

14. Therefore, having regard to the explanation given in the affidavit-in-opposition I think that the decision to raise funds is for the interest of the

company and to augment the income and extend the business. The Petitioners," therefore, will also be benefited if the business is diversified and

there is any prospective increase of profit. The case cited by Mr. Sarkar in Piercy v. S. Mills and Company Ltd. (1920) 1 Ch D 77, is of no

application factually as in that case it was found on evidence that preferential share was issued in order to deprive the majority shareholders

patently and for their own benefit and not for the benefit of the company. It was a case where in order to avoid the appointment of additional

directors from and amongst the majority shareholders the existing directors took a decision to issue preferential shares to a few chosen persons of

their own, as such, in that case the court did not approve of the decision.

15. Here is a case of rights issue of shares for the existing shareholders in equal proportion. It is for the Plaintiffs/Petitioners to decide whether they

would take a risk for rendering themselves to minority. Accordingly, I do not find any reason to interfere with this decision. I make it clear that in

the event any numbers of the rights shares are remaining unsubscribed, the same may be allotted in a rational basis so that there shall not be

alarming accumulation of shareholdings in one single hand or in one group. This should be allocated It existing willing shareholders rationally and

equally as far as practicable in accordance with their existing number of shareholding.

16. The other interim relief to the effect is that if the board of directors decides to issue any preferential share, the prior leave of this Court shall be

obtained after giving prior seven days notice to the Plaintiffs/Petitioners. Thus, this application is disposed of with the aforesaid observation and

directions. Save and except as above the interim order passed earlier shall be vacated.

17. There will be no order as to costs.