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OVERVIEW

Insolvency Professional Agency of Institute of Cost Accountants of India (IPA ICAI) is a Section 8 Company incorporated under the Companies Act -2013 promoted by the Institute of Cost Accountants of India. We are the frontline regulator registered with Insolvency and Bankruptcy Board of India (IBBI). With the responsibility to enrol and regulate Insolvency Professionals (IPs) as its members in accordance with provisions of the Insolvency and Bankruptcy Code 2016, Rules, Regulations and Guidelines issued thereunder and grant membership to persons who fulfil all requirements set out in its byelaws on payment of membership fee. We are established with a vision of providing quality services and adhere to fair, just and ethical practices, in performing its functions of enrolling, monitoring, training and professional development of the professionals registered with us. We constantly endeavour to disseminate information in aspect of Insolvency and Bankruptcy Code to Insolvency Professionals by conducting Round tables, webinars and sending daily newsletter namely "IBC Au courant" which keeps the insolvency professionals updated with the news relating to Insolvency and Bankruptcy domain.

INDEX

WHAT CONSTITUTES THE URGE TO INITIATE INVESTIGATION INTO AFFAIRS OF THE COMPANY U/S 213?

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The Section 213 of the Companies Act, 2013 empowers the NCLT to order an investigation into the affairs of the company on grounds of fraud, misfeasance or misconduct or withheld of information being done within the company. The debatable question of law that arises here is that "what all actions had been previously recognised by the courts in past to be sufficient enough to urge an Investigation under Section 213". The Authors have made an exhaustive attempt in this research study to discuss specific judicial observations of NCLTs and erstwhile company courts which are necessary to understand the position of law in relation to the abovestated question, and the interrelation of the power under Section 213 with the proceedings under Insolvency and Bankruptcy Code, 2016

INTRODUCTION

A company, whether private or public, plays a pivotal role in driving the base and superstructure of the economy of a country. Besides earning profits, a company lays down its traces over the society, and the manner in which the corporate governance is carried on within the company has been important. But, whenever the internal management or the persons in charge of management redirects the affairs of the company to their personal gains and interests, and the corporate governance lacks in transparency & accountability, then there comes the need of an investigation into the affairs of the company, which is embodied under Section 213 of the Companies Act of 2013 (been brought into force w.e.f. 01.06.2016). The provision for investigation into the affairs of the company is not new, the similar provision was also there in the Companies Act, 1956 (Section 237).

Section 213 of the Companies Act, 2013 empowers the National Company Law Tribunal (hereinafter referred to as 'Tribunal') to order an investigation by the Central Government in cases, wherein, an application is made by the certain persons, seeking an investigation into the

affairs of the company or on an application suggesting fraud, misfeasance or misconduct or when any information is withheld. The said provision of law further empowers the Central Government to appoint Inspectors and seek report, on the basis of which, stringent punishment for fraud can be imposed by appropriate authority under Section 447 of the Act.

For better understanding and linking the further deliberations, the relevant portion of Section 213 is reproduced hereunder:

"213. The Tribunal may, —

(a) On an application made by—

(i) not less than one hundred members or members holding not less than one-tenth of the total voting power, in the case of a company having a share capital; or

(ii) not less than one-fifth of the persons on the company's register of members, in the case of a company having no share capital, and supported by such evidence as may be necessary for the purpose of showing that the applicants have good reasons for seeking an order for conducting an investigation into the affairs of the company; or

(b) on an application made to it by any other person or otherwise, if it is satisfied that there are circumstances suggesting that—

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

(ii) 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) the members of the company 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, or the manager, of the company,"

Upon in-depth reading of the aforementioned provision of law, it can be stated that Section 213 puts forth two classes of persons who can approach the tribunal invoking provisions of Section 213 i.e.) members of the concerned company under clause (a) and 'any other person' under clause (b). The clause (b) provides for circumstances, which shall warrant the tribunal that an investigation into the affairs of the company is ought to be done or is necessary to be undertaken. It is pertinent to mention here that clause (b) of Section 213 has a wide amplitude because of inclusion of the term 'any other person' which enables any stakeholder in a company, other than its members, to file an application seeking investigation in the management/affairs of the concerned company. However, The debatable question of law that arises here is that ***"what all actions had been previously recognised by the courts in past to be sufficient enough to urge an Investigation under Section 213"***. The Authors have made an exhaustive attempt in this research study to discuss specific judicial observations which are necessary to understand the position of law in relation to the above stated the question of law.

CONTENT

From a bare reading of the Section it is clear that the circumstances under which investigation can be ordered under clause (a) of Section 213 are wholly different from those enumerated under clause (b). Under clause (a) it is enough for the applicant to give evidences to show that there are good reasons to carry out an investigation in to the affairs of the company. Whereas, under clause (b) it is necessary to satisfy the authority/tribunal that the business of the company is being conducted fraudulently or unlawfully or the persons concerned in the management are guilty of fraud or misfeasance or there is concealment of relevant information. Therefore, the scope for ordering investigation under clause (a) is far wider than the scope under clause (b) where an element of fraud is required to be proven to the satisfaction of the tribunal. Under clause (b), the tribunal is empowered to order investigation *Suo moto* if the circumstances detailed therein exist.

INTER-RELATION BETWEEN IBC AND SECTION 213 OF THE COMPANIES ACT, 2013

In respect of investigation into affairs of the company under insolvency, the NCLAT in Lagadapati Ramesh v. Ramanathan Bhuvaneshwari [I (2020) BC 28], held that the NCLTs/NCLAT on receipt of application of alleged violation of Section 213, 447 of the Companies Act, 2013 or 68, 69, 70, 71, 72 and 73 of the Insolvency and Bankruptcy Code, 2016, on such consideration and being satisfied that there are circumstances suggesting that defraud etc. has been committed, may order investigation and direct Central Government to take further action.

The CLB in Mayank Kocher v. Transport & Handling Equipments MFG. Co. P. Ltd, [(2008) 143 Comp Cas 601 (CLB)], while discussing section 235 of the erstwhile Act held that,

"Under this Section directing an investigation is only analogous to the issue of a fact-finding commission by a civil court for looking into accounts or making an investigation and does not amount to a judgment within Clause 15 of the Letters Patent, so as to enable an aggrieved party to appeal."

In the case of M. Srinivas v. Ramanathan Bhuvaneshwari Resolution Professional & Ors., 2019 SCC Online NCLAT 1001, the question for consideration before the NCLAT was whether the Adjudicating Authority, having dual jurisdiction under the Companies Act, 2013 and the Insolvency and Bankruptcy Code, 2016, can direct the Central Government to refer the investigation into the affairs of the Corporate debtor and other group of companies. The NCLAT held to affirmative and observed to the effect that provisions of law make it clear that the National Company Law Tribunal is empowered to deal with Insolvency resolution and liquidation for corporate persons including corporate debtors. Therefore, merely because additional power has been vested in the authority, the power to pass order under Section 213 the Companies Act, 2013 read with Rule 11 of the National Company Law Tribunal Rules, 2016 does not stand extinguished.

RESTRICTIVE APPROACH VIS-À-VIS CLAUSE (B) OF SECTION 213

In the early 1980s, the Kerala High Court in Mrs U.A. Sumathy and Anr. v. Dig Vijay Chit Fund (P) Ltd., [1983 53 CompCas 493 (Ker)], observed to the effect that section 235 of the Companies Act, 1956 does not postulates precise circumstances which are to be proved, so as

to trigger an investigation, but in the least, the materials on record to be examined must be such as to satisfy the court that a deeper probe into the company affairs are desirable in the interest of the company.

Similarly, in Hariganga Cement Ltd. v. Company Law Board & Anr. [(1988) Bom 603], Bombay High Court held to the effect that the power of the adjudicating authority i.e. erstwhile Company Law Board under section 237(b) of the Companies Act, being wide in nature and scope, should be exercised with immense circumspection and in a judicious manner. It was noted that such discretionary power would have to be exercised in a reasonable manner and not in the absence of circumstances not warranting investigation, into the affairs of the company.

In the matter of Binod Kumar Kasera vs Nandlall & Sons Tea Industries (P) Ltd. & Ors [(2010) 153 Comp. Cas. 184 (CLB)], it was made clear that a prima facie evidence and something more substantial than an allegation will be required. The authority held that,

"where the facts are disclosed on the basis of the records like the balance sheet of the company, an investigation would not be ordered. Hence, there must exist at least a prima facie evidence that the affairs of the company are being run in a fraudulent and unlawful way so as to defraud its creditors or is contrary to the interest of the company itself which would lead to the conclusion that an investigation would be necessary. Mere allegation of a disgruntled shareholder would not be a sufficient ground to order an investigation".

In Mrs. U.A. Sumathy v. DIG Vijay Chit Fund (P) Ltd. [(1983) 53 Comp. Cas. 493], the Single Judge of the Kerala High Court considered the scope of Section 237 of the Act of 1956 and observed that,

"clause (a)(ii) of Section 237 does not lay down the circumstances that are to be proved and the materials on which a Court could act, but that does not mean that mere allegations are sufficient. A Court can act only on the materials placed before it and the materials should at least be such as to satisfy the Court that a deeper probe into the company's affairs is desirable in the interests of the company itself. No investigation could be ordered merely because a

shareholder feels aggrieved about the manner in which the company's business is being carried on."

The judicial ruling of the Hon'ble Supreme Court in Rohtas Industries Ltd, v. S.D. Agarwal [(1969) 13 SCR 108] is of relevance for the present study, as the apex court opined upon the nature of investigative powers under the concerned provisions of law and that the scheme of these Sections makes it clear that unless proper grounds exist for investigation of the affairs of a company, such investigation will not be lightly undertaken. The rationale behind such an approach is that an investigation may seriously damage a company's reputation and should not be ordered without proper material gathered in the manner provided in the Act. The power of investigation has been conferred, with a belief that a reasonable standard of care will be exercised which can only be exercised by an expert and not an ordinary person.

Moreover, in Binod Kumar Kasera vs Nandlall & Sons Tea Industries (P) Ltd. & Ors. [(2010) 153 Comp. Cas. 184 (CLB)], the CLB held that where the facts are disclosed on the basis of the records, like the balance sheet of the company, an investigation would not be ordered. Hence, there must exist at least a prima facie evidence that the affairs of the company are being run in a fraudulent and unlawful way so as to defraud its creditors or is contrary to the interest of the company itself which would lead to the conclusion that an investigation would be necessary. Mere allegation of a disgruntled shareholder would not be a sufficient ground to order an investigation.

It is averred that the adjudicating authority under Section 213 of the Act shall exercise its power sparingly and only in circumstances which warrants so. The position of law stated herein above was followed by the National Company Law Tribunal, the adjudicating authority herein, in the case of S.Z. Zairudeen v. KRK Properties Pvt. Ltd., 2018 SCC Online NCLT 30188. In the noted case, the authority, while rejecting petition seeking investigation u/s. 213, observed to the effect that whenever a case is filed invoking the provisions of the Section 213 (a) of the act, the parties to litigation shall prima facie substantiate the averments/allegations made therein. It was held that an enquiry cannot be ordered for failure of the company to adhere

Section 12 of the Companies Act, 2013, as the Registrar of Companies is the appropriate authority in the said cases.

CIRCUMSTANCIAL AND INCLUSIVE JUDICIAL APPROACH

Though the adjudicating authorities, appellate court and the apex court, in certain cases, have clearly enumerated and adopted narrow approach, whenever a power u/s. 213 is invoked and have inclined to dismiss the same in absence of clinching material on record, still there have been cases, wherein, the courts have adopted liberal approach.

In PR Ramakrishnan v. V.R. Textiles Ltd. [C.P. No. 37 of 1991], the Company Law Board had held that the cases of dishonesty, lack of probity, malafide for personal gain on the part of the management would warrant investigation into the affairs of the company.

Similarly, in Incab Industries Ltd., In re [(1996) 10 SCL 390 (CLB)], CLB gave a notice to the circumstances mentioned in the Section urging investigation, and believed the following circumstances to be sufficient enough for making a prima facie case for investigation: Diversion of funds and project money, laxity in collection of loans, payment of commission without justification, wasteful expenses, etc.

In T. Kannan v Shapre Info tech India Ltd, [(2014) 186 Comp Cas 193 (Mad)] an investigation was ordered by CLB. Further, the adjudicating authority, while passing the order, observed that the existence of following circumstances are sufficient enough for making a prima facie case for investigation: failure to list shares in the Stock Exchange and/or give notices to shareholders, failure to comply with earlier orders of the court to furnish documents to the chartered accountant appointed by the court for formation of opinion regarding accounts, total non-cooperation by promoters and senior management and apparently conducting business in a manner oppressive to its members.

The courts have considered duly imparting of relevant financial information to shareholders as a crucial obligation of a company. In Hindustan Co-operative Insurance Society Ltd., In re [(1961) 31 Comp. Cas. 193 (Cal.)], wherein the shareholders were left completely in the dark, as no annual general meeting was being called since years, and no information was shared

regarding the manner in which the affairs of the company were being conducted, directors dealt with the company's money in any fashion they liked and apparently prejudicial to the interest of the company, the court considered these acts to be oppressive and warranting investigation in to the affairs of the company.

Recently, the Hon'ble National Company Law Appellate Tribunal in the case R.S. India Wind Energy Pvt. Ltd. v. PTC Energy, 2016 SCC Online NCLAT 10, observed that the provisions of the Section 213 require the adjudicating authority to form an opinion in regard to ingredients as enumerated in clause (i), (ii) and (iii) of clause (b) of the said section. It is worthwhile to mention herein that the adjudicating authority is not required to form opinion objectively, and is only required to satisfy itself on the basis on material on record that the case concerned requires ordering of investigation. It was held that detailed evidence, collection and scrutiny thereof, is not the responsibility of the authority at the initial stages and that it has to be undertaken by the inspector during the investigation.

However, in Barium Chemicals Ltd. v. Company Law Board, [(1966) 36 Comp Cas 639 (SC)] & Shankar Sundaram v. Amalgamations Ltd. [(2002) 111 Comp Case 252 (Mad)] the Hon'ble Supreme Court and High Court were of opinion that, an investigation under S. 237 (of the erstwhile Act) can be directed upon the subjective satisfaction of the existence of circumstances as enumerated in the said section. This means that if the CLB comes to the conclusion that circumstances as mentioned in Section 237 do not exist, or that it is not possible to form such an opinion of the existence of such circumstances on the basis of available facts and allegations made by the applicant, then no investigation will be warranted.

An interesting finding was seen in an order of the Delhi High Court in the noted case of Amaan Sachdev & Ors. V. Fahed Abdulrahman Ali Alkhamiri [CO.A.(SB) 39/2013], that if the substances upon which the application seeking investigation is preferred are those facts which were already known to the parties through the statutory filings of the company, no further information would come out from the investigation, hence no action for investigation ought to be order.

CONCLUSION

It can be safely concluded by stating that every power has to be exercised judiciously and in a purposeful manner. Similarly, the force put forth by the Section 213 of the Companies Act, 2013 is to instil a sense of respect towards adherence of law, in the business community. After an in-depth analysis of various judicial pronouncements, it can be averred that the legislative intent behind enacting Section 213 was to prevent scrupulous business methods and practices, but definitely not to cause a sense of worry in well-structured, managed and law-abiding companies of the nation. The prima facie proof element in the aforesaid section enables the authority to filter out vexatious litigations aimed primarily to cause unjust loss to companies. The judicial trend clearly embodies the principle that an investigation into affairs of a company cannot be taken as a matter of course, but only in cases where there is a prima facie basis to sustain allegations of fraud, misconduct, mismanagement etc.

It is imperative for the adjudicating authority, while ordering for the investigation or otherwise, to disclose the basis and circumstances which has warranted such a decision. It is pertinent to mention herein the prolonged investigative recourse being adopted by the inspectors under Section 213, which ultimately leads to detriment of the innocent companies, shall be avoided. The Indian Judicial System has often reprimanded frivolous and vexatious usage of Section 213 and curbed misuse of the said provision of law. However, it is not possible to ensure proper checks and balances in each and every case seeking investigation into affairs of a company, especially wherein the order for investigation has been passed and is being used by the agencies as a tool of harassment against the concerned company. Thus, no such order shall be passed without affording the company an opportunity to present its case or justify the averments of the petition being filed against it under Section 213.