Seneviratne v. Seneviratne

COURT OF APPEAL.
ABDUL CADER, J. AND RODRIGO, J.
C.A. (S.C.) 46/74 (F) AND 110/74 (INTY.)—D.C. COLOMBO 1556/SPL.
SEPTEMBER 16, OCTOBER 29, 1980.

Company Law—Winding-up—Court's powers under amending Act No. 15 of 1964—Legal status of a private company reduced to only one member—Deadlock.

The petitioner E, his brother C, and their brother the respondent T, each owned 2,220 shares in a private company called 'Kadirana Mills Ltd'. The fourth shareholder was their deceased brother J, whose 2,250 shares remained unallotted.

In an action brought by E to wind up the company on the ground of deadlock, the evidence at the inquiry disclosed that he had kept away from the meetings of the company from about 1952 and had taken no interest in regard to the affairs of the company ; that C was not interested in performing his functions as secretary of the company and was on his own admission completely disinterested in the company ; but that T as managing director had devoted the entirety of his working life to the affairs of the company and had made considerable profits in the company's business.

The learned District Judge held that there was disharmony between the three brothers ; that there was a complete deadlock as between the three of them ; that it is not possible for the shareholders or the board of directors to function as required by law ; that matters in regard to the due administration of the company have come to a complete standstill ; and that therefore it appeared to him that the petitioner was entitled to have the company wound up. He considered an alternate proposal put forward at the inquiry by T, namely that since he would be prejudiced if the company was wound-up, E and C should be directed to sell their shares to him. The Judge refused to accede to this proposal on the ground that he had no power to do so since in his view such a power could only be exercised under section 153E (b) of the amending Act No. 15 of 1964 if a case of oppression had been made out in terms of section 153A, or a case of mismanagement had been made out under section 153 B, of this amending Act, and that no such case had been put forward by the respondent T, or was made out on the evidence. The Judge also held the view that if E and C were directed to sell their shares to T. there would be only one member left in the company and as such it would cease to exist.

Held

(*a*) That a private company did not cease to exist if it was reduced to only one member, but that in such a case the provisions of section 29 of the Companies Ordinance applied providing that if the company carried on business for more than six months while the number is so reduced, the remaining member is liable for the whole debts of the company contracted during that time and may be sued therefor.

(*b*) That section 153D of the amending Act No. 15 of 1964 enabled the Court to exercise its powers under section 153E at any stage of winding-up proceedings even though the ingredients of oppression and mismanagement set out in sections 153A and 153B were not alleged and proved; but that in any event in instant case there was evidence before the District Judge establishing these ingredients.

(c) That the spirit of the amending Act No. 15 of 1964 which gives enormous powers to the Court appears to be that a Court should desist from making a winding-up order by adopting every possible method to prevent it.

The order for winding up was set aside and the record sent back to the District Court to value the shares of E and C and allow T to purchase them.

Cases referred to

(1) *Jarvis Motors Ltd. v. Carabott, (1964) (3) All E.R. 89.*

APPEAL from an order of the District Court, Colombo.

H. W. Jayewardene, Q.C., with *K. N. Choksy* and *Ronald Perera*, for the appellant.

C. Ranganathan, Q.C., with *A. J. I. Tillakeratne*, for the respondent.

Cur. adv. vult.

November 24, 1980.
ABDUL CADER, J.

The petitioner Eardley Seneviratne and Trevor Seneviratne and Cedric Seneviratne are three brothers each of whom holds 2,220 shares in Kadirana Mills Limited. Yet another brother Ivan who had 2,250 shares is dead and his share remains unallotted. Trevor was the managing director of the company. The petitioner has made several charges against Trevor and he has been supported by Cedric who himself made several allegations in the document produced marked P22. The petitioner prayed for an order of Court that the company be wound up and that a provisional liquidator be appointed to take charge of the company books and property, etc. Trevor opposed this application. After a long inquiry, the learned District Judge allowed the application to wind up the company and to appoint an official receiver. This appeal is against that order.

It was agreed before us that the learned District Judge has given an adequate summary of the various charges in the 3rd paragraph of his judgment commencing at page 258 of the brief. The learned District Judge held that there was disharmony between the three brothers; that there was a complete deadlock

as between the three of them ; that it is not possible for the shareholders or the Board of Directors to function as required by law ; that matters in regard to the due administration of the company have come to a complete standstill, and that, therefore, it appeared to him that on this ground alone the petitioner is entitled to invoke the provisions of section 122 (6) of the Companies Ordinance.

Then. he went on to consider an alternative proposal that had been put forward by Trevor to avoid the winding up of the company, namely, that Eardley and Cedric be directed to sell their shares to Trevor. The learned District Judge carefully considered this proposal and found that such an order had to be made under section 153E (b) of the amending Act No. 15 of 1964, but he had no power to do so for the reason (1) that section 153E (b) is dependent on the Court's power to make an order under either section 153A or section 153B and section 153A would not apply as he had come to the conclusion that no case of oppression has been made out and that, in any event, even if the petitioner has been oppressed he did not complain that any prejudice would be caused to him by making an order to wind up the company ; and that section 153B would not apply because no mismanagement has been proved ; nor has there been any material change brought about, and (2) if Eardley and Cedric are directed to sell their shares, there would be only one member left in this company and the company as such would cease to exist. Therefore, he refused to make an order directing Eardley and Cedric to sell their shares to Trevor and directed that the company be wound up.

Mr. Jayewardene accepts the finding of the learned District Judge that there was a deadlock and that there was no possibility of the Board meeting and functioning. He did not dispute the right of the learned District Judge to order winding up in these circumstances, but submitted that such an order should not be made except as a last resort. He submitted that the Court has to take into consideration (1) the interests of the Managing Director, namely, Trevor, who had nurtured and built up this business for over a decade to its present position ; (2) the interests of the country in that a considerable amount of foreign exchange is earned by the export of dessicated coconut and (3) the interests of labour who will be thrown out of employment.

Taking first the second reason given by the learned District Judge for his refusal to order a sale of shares. Mr. Jayewardena submitted that the Judge was wrong when he stated that the company ceases to exist because only one member was left. With this proposition. Mr. Ranganathan agreed, but Mr. Ranganathan

went on to support the learned District Judge for the reason that the conduct of business by a company which has only one member left would be illegal and that the Court would not be a party to make an order which would permit illegal operation of business by such a company. Mr. Jayewardene referred us to section 29 of the Companies Ordinance which reads as follows :—

> "If at any time the number of members of a company is reduced, in the case of a private company, below two, or, in the case of any other company, below seven, and it carries on business for more than six months while the number is so reduced, every person who is a member of the company during the time that it so carries on business after those six months and is cognizant of the fact that it is carrying on business with fewer than two members, or seven members, as the case may be, shall be severally liable for the payment of the whole debts of the company contracted during that time, and may be severally sued therefor."

Mr. Jayewardene submits that this section permits the business to go on, but makes the single member left in the company liable for the payment of the whole debts of the company. The heading of this section is "Reduction of number of members below legal minimum" and the side-heading. "*Prohibition* of carrying on business with fewer than seven or, in the case of a private company two members." Palmer in *Palmer's Company Law*, Twentieth Edition, pages 129 says :—

> "Even if the number of members falls below that required by the statute, the company continues to have a separate corporate existence ..... On occasions a company may even be left with no directors or shareholders alive, but the company does not thereby cease to exist."

He goes on to discuss the procedure adopted to break the deadlock in such a situation. These passages establish what Mr. Ranganathan has already conceded, namely, that the company continues to have a separate corporate existence, but there is nothing in Palmer about his contention that such a company is prohibited from continuing in business. Even the contents of note 4 of Halsbury's *Laws of England*, Fourth Edition, Vol. 7 page 97 which reads :—

> "It is thereafter unnecessary that there should be more than one member, although certain consequences may follows if there is no more."

does not help Mr. Ranganathan's contention that such a company is prohibited from carrying on business.

Mr. Jayewardene then referred us to the case of *Jarvis Motors Ltd. v. Carabott* (1). I do not think that that case would be of any assistance for the reason that what was decided in that case was that shares belonging to a deceased member should be allotted by Court to the sole surviving member in terms of the articles notwithstanding the fact that there was only one member left. Therefore, that case will not be helpful to decide the question before us. That was a case decided when the Companies Act of England of 1948 was in operation. It is interesting to note that in that Act, section 31 which corresponds to our section 29, though it has the same heading, "Reduction of the number of members below legal minimum" has the side-note. "Members severally liable for debts where business carried on with fewer than ..... 2 members," and not "prohibition" as in our Ordinance. In the case of *Jarvis* referred to earlier, Ungoed-Thomas, J. stated:—

> "It seems to me quite clear, therefore, that under the provisions of section 135, the court could on proper application being made direct a one member meeting and provide at that meeting for any alteration in article 15 should that be considered advisable at that meeting."

(Article 15 was the matter in dispute in that Act). Our own Ordinance, Chapter 145 has a similar provision 113 (2), but the last portion of section 135 (1) of the English Act is not found in our 113 (2), namely, "and it is hereby declared that the directions that may be given under this subsection include a direction that one member of the company present in person or by proxy shall be deemed to constitute a meeting." I do not propose to decide at this stage whether this omission has any significance so far as these proceedings are concerned.

Section 153E empowers a Court to make any order providing for (b) the purchase of the shares or interests of any member of the company by other members thereof or by the company and (g) any other matter for which, in the opinion of the Court, it is just and equitable that provision should be made. Section 153G (1) enables a Court to make alterations in the memorandum or articles of the company and under subsection 2 the alterations made by the order shall, in all respects, have the effect as if they had been duly made by the company in accordance with the provisions of this Ordinance.

In view of the wide powers given to the Court in terms of section 153A, B and C I do not think that section 29 should stand in the way of directing a transfer of shares of Cedric and Eardley if the Court can make it possible for the company to

continue without being wound up. In fact, within 6 months, Trevor would yet have the opportunity to transfer some of his shares to his children to meet the prohibition contained in section 29.

But before we decide to make an order for the sale of shares, it is necessary to consider whether section 153D on which Trevor relies can defeat petitioner's claim that the company be wound up. Section 153D reads as follows:—

> "Notwithstanding the provisions of Part V of this Ordinance at any stage of the winding-up proceedings in respect of a company, where a court is of the opinion that to wind up the company would be prejudical to the interests of a member of the company, it shall be lawful for the court to act under section 153A or 153B in like manner as if an application has been made to court under either of those two sections."

Chapter V referred to deals with winding-up proceedings. "At any stage of the winding-up proceedings" would include the stage when a District Judge makes his order. Therefore, Trevor submits that when the District Judge comes to the opinion that to wind up the company would be prejudicial to "the interests of a member of the company", namely himself, Trevor, he is empowered to act under section 153A or B *"in like manner as if an application has been made to Court under either of the two sections."* The two counsel did not agree as regards the constructions of the last portion of the section which I have underlined. But both counsel agreed that the District Judge could act under section 153A or 153B if he was of the opinion that prejudice was caused to a member, but Mr. Ranganathan, however, cited authorities for the proposition that where circumstances exist that would require that a company be wound up specially under section 162 (6) where the Court is of the opinion that it is just and equitable that a company should be wound up, the Court would not be slow to make an order winding up the company. He pointed out that Eardley and Cedric had suffered considerably by the arbitrary manner in which Trevor had conducted the business of the company and, therefore, the order of the learned District Judge winding up the company should not be disturbed. As against this, there is the fact that the learned District Judge had held that although several allegations were made against Trevor, all these allegations have been satisfactorily met by Trevor and these allegations, except one, do not warrant such an extreme step as winding up and no acts of oppression or mismanagement have been substantiated against Trevor. The one allegation which he found established was that there was a

disharmony among the three brothers; there was considerable dissension and a complete deadlock and that it is not possible for the shareholders or the Board of Directors to function as required by law and that matters in regard to the due administration of the company have come to a complete standstill, and went on to state that he would not hesitate if he had the power to do so to direct Eardley and his brother Cedric, to sell their shares to Trevor *if by doing so the company could be allowed to carry on its business.* (The emphasis is mine). The only reason why he made an order directing that the company be wound up was that if Eardley and his brother Cedric, were directed to sell their shares to their brother, Trevor, then there would be only one member left and the company as such would cease to exist. In any event, the cases cited by Mr. Ranganathan were before Act No. 15 of 1964. This Act changes the scope altogether and clothes Court with very wide powers to prevent as far as possible a winding up of the company, may be for the social and economic causes, Mr. Jayewardene urged, and I take the view that this court should make every effort to prevent a company from being wound up, which order should be made only as a last resort.

Coming now to section 153D, both counsel differed as regards the interpretation of the last portion of section 153D which I have underlined. Mr. Ranganathan contended that these words clearly indicate that if Trevor wished to obtain an order under section 153D, he should prove the ingredients set out in section 153A (1) or section 153B (1) or section 153B (2), namely the affairs of the company are being conducted in a manner oppressive to Trevor and that to wind up the company would unfairly prejudice Trevor and/or that the affairs of the company are being conducted in a manner prejudicial to the interests of the company or that a material change has taken place in the management or the control of the company, and that by reason of such change, it is likely that the affairs of the company will be conducted in a manner prejudicial to the interests of the company.

Mr. Jayewardene submitted that all that Trevor has to establish is that his interests are prejudiced by an order winding up the company and that he need not prove the ingredients in section 153A or B referred to earlier.

Section 153A is put in motion by any member or members on a complaint that the affairs of the company are being conducted in a manner oppressive to him or them. Therefore, that section requires the member or members to establish the truth of that allegation, before the Court is required to consider whether it would unfairly prejudice such member or members.

Under section 153B, similarly, any member or members having a complaint that the affairs of the company are being conducted in a manner prejudicial to the interests of the company or that a material change has taken place, and that by reason of such change it is likely that the affairs of the company will be conducted in a manner prejudicial to the interests of the company, applies to the District Court for relief. Therefore, that allegation must be established before the Court makes an order. But under section 153D there is no member making an allegation as under section 153A or B and therefore, in my opinion, no need to prove any allegation. It is the Court that finds that to wind up the company would prejudice the interests of a member of the compainy and makes its order. What is essential is a finding of prejudice. What is essential in all instances is that the Court should form the opinion of prejudice, but in the first two, in addition the person alleging should prove his allegation. Therefore, it appears to me that there is no requirement in section 153 D when the Court comes to a finding of prejudice that the allegations of oppression or mismanagement as required by section 153A and B should be proved.

But Mr. Ranganathan contends that the words " in like manner as if an application has been made " would suggest a commencement of proceedings under A or B and, therefore, an inquiry which is to be followed by an opinion by Court that the allegations have been established. For the reasons given earlier, I am inclined to take the view that the reference to A and B in D is a reference merely to the order made under A or B.

However, I shall, proceed to conclude whether Trevor has established oppression or mismanagement so that the Court can make such order as it thinks fit. Mr. Ranganathan submitted that this Court will not make an order on the evidence available in this case for the reason that this plea that Trevor was oppressed (under A) or there was mismanagement (under B) was not brought into focus in the District Court, and that it may be possible for his clients to place material before the District Judge to rebut the claims of Trevor if this record is sent back to the District Court.

Mr. Jayewardene disagreed violently and submitted that the mills are closed and are deteriorating, watchers are being paid out of the assets of the company which are being sold and considerable loss would be suffered by the shareholders of the company. As usual, no issues were framed in this case and, therefore, there was no possibility of focussing this claim of Trevor at the initial stage of this inquiry. But Trevor had prayed for an order for sale of shares, and that can be only under section 153E and

that can be done only by bringing 153A and B into play. Section 153D can be resorted to at any stage of the winding up proceedings so that even the stage at which the order is made by the District Judge is an appropriate stage for the Judge to consider whether he should take action under section 153D. I find that this matter has been discussed in the course of the submission made to the Judge, oral and written, before the Judge made his order. Parties are presumed to know that if the Court took the opinion that the interests of Trevor were prejudiced, the court could make an order under section 153D even though the claim of Trevor of oppression is not focussed during the inquiry. Therefore, the petitioner should have placed whatever evidence he had at his disposal at the inquiry itself to rebut a possible claim by Trevor or a possible order by Court that he should be given relief under section 153D. Therefore, when Eardley and Cedric failed to place, in the course of the inquiry, whatever, evidence that Mr. Ranganathan says may be available to them if this record is sent back, they failed to take advantage of the opportunity that they had and it is now too late to claim that there would be a violation of natural justice if an order is made without giving Eardley and Cedric another opportunity to place evidence. I, therefore, hold that it is proper for this Court to make a decision on the evidence available in this case.

Mr. Ranganathan agreed that after the record is sent to the District Judge and fresh evidence is recorded, the District Judge has the right to consider whether there has been oppression to Trevor or there had been mismanagement of the company in terms of section 153A and B and if he finds that either of these has been established to give relief under section 153A or B and E. Now that I have held that it is not necessary to send this record back to the District Court, I proceed to consider whether there is evidence in the record from which we can hold that oppression and mismanagement have been established. Mr. Jayewardene referred us to the evidence on page 69, the evidence of Cedric, that Trevor was not entitled to continue as Managing Director after about 1958, at page 80 that he was not able to prove the 17 disputes that he had listed except item 12 and even to prove that he wanted a date, although it was the third date of trial ; at page 88, that he was not interested in performing the functions of a secretary although he was the secretary ; at page 90, he did not take the trouble to find out where the books were because he was completely disinterested in the company ; at page 109 that though he was the Director of the company, he did not examine the balance sheets ; that he did not know about the assets of the company ; that he was absolutely disinterested in the affairs of the company and he was

supporting this application for winding up the company without knowing the affairs of the company, and that he refused to take any further interest in the company.

Mr. Ranganathan was not in a position to draw our attention to any evidence to the contrary. The learned District Judge has stated at page 259 "that the petitioner had kept away from meetings of the company from about the year 1952 and had taken no interest in regard to the affairs of the company. On the other hand, Trevor had devoted the entirety of his working life to the affairs of the company and the position of the mills which had also been churning out considerable profits had been mainly due to the untiring efforts of Trevor."

All these circumstances clearly point to a situation where considerable prejudice would be caused to the interest of Trevor whose entire working life had been directed to the affairs of the company and whose livelihood depends on the income derived from the company. The question is whether there has been oppression of Trevor. When the only two other shareholders of the company, namely, Eardley and Cedric, of whom Cedric was the secretary refused to attend meetings and created a deadlock whereby the company is unable to function efficiently, the only conclusion that the Court can come to is that the two of them caused oppression to Trevor because if the affairs of the company are conducted in harmony, the company would be able to function more efficiently and possibly make more profits to the benefit of all the shareholders, including Trevor. Definitely, a material change has taken place in the management and control of the company that "it is likely that the affairs of the company will be conducted in a manner prejudicial to the interests of the company." I am of the view that even on the interpretation placed by Mr. Ranganathan on the last part of section 153D Trevor is entitled to relief.

The spirit of Act No. 15 of 1964 giving enormous powers to Court appears to be that a court should desist from making a winding up order by adopting every possible method to prevent it. The social and economic causes which were put forward by Mr. Jayewardene to which I referred in the earlier stages of this order may have some bearing on this Legislation, but whatever be the cause there is no doubt that this amendment is intended to prevent an order for winding up if it is possible within the powers of the Court to do so by making an order as it thinks fit of which the sub-heads under section 153E are only some of the powers which by themselves are of a very radical nature.

I have, therefore, come to the conclusion that this is a case where, in the interest of the company, Eardley and Cedric should be directed to sell their shares to Trevor and I make order accordingly.

In fact, Eardley and Cedric had negotiated the sale of their shares to Trevor which had fallen through because they could not agree on the price. On 1st December, 1973, counsel for Eardley agreed to Court making an order directing the petitioner's shares to be sold to Trevor Seneviratne at a price to be fixed by Court provided certain matters which he classified under seven heads be taken into consideration in fixing the value. As Cedric's senior counsel was not present, the case was put off for the 15th December, 1973, when counsel for Cedric stated that his client would not consent to the matter being settled on the terms suggested by counsel for the petitioner. It was only thereafter that learned District Judge made his order.

The order for winding up is set aside. The record will be sent back to the District Court to value the shares of Eardley and Cedric in terms of the law. In doing so, the Court will take into consideration the matters set out by counsel recorded on pages 253 to 255 of the brief and any other matter that would be brought to the notice of Court by the three parties concerned in this case.

Eardley and Cedric will pay to Trevor the costs of the District Court and this Court.

RODRIGO, J.—I agree.

Appeal allowed.

K. Thevarajah,
Attorney-at-law.