
(2015) 07 BOM CK 0242

In the Bombay High Court

Case No : Company Application No. 250 of 2014 in Company Petition No. 521 of 1992 and Official Liquidator's Report No. 179 of 2012

Henkel Chemicals (I) Ltd.

APPELLANT

Vs

Garware Nylons Limited

RESPONDENT

Date of Decision : 22-07-2015

Acts Referred:

Companies Act, 1956 — Section 108, 531A, 536(2)
Contract Act, 1872 — Section 176
Transfer of Property Act, 1882 — Section 122, 123

Citation : (2016) 1 BomCR 406 : (2015) 128 CLA 445 : (2015) 192 CompCas 204 : (2015) 4 CoMPLJ 293 : (2015) 132 SCL 583

Hon'ble Judges : S.C. Gupte, J

Bench : Single Bench

Advocate : Janak Dwarkadas, Senior Advocate, Aditya Thakkar and Deepak Shukla, i/b. Vinod Mistry and Co., for the Appellant; J.P. Sen, Senior Advocate, Rakesh Reddy and Party-in-Person, Advocates for the Respondent

Final Decision : Disposed off

Judgement

S.C. Gupte, J—This application is for seeking validation under Section 536(2) of the Companies Act, 1956 ("the Act") of (i) a pledge agreement between the Applicant and the Company in liquidation, (ii) invocation of the pledge and (iii) transfer of shares belonging to the Company in liquidation.

2. Garware Nylons Limited is a Company in liquidation (hereinafter referred to as "the Company"). The Applicant was a purchaser of yarn from the Company before the winding up petition was presented. Since its inception in the year 1975, the Applicant has been purchasing yarn from the Company. On 8 October 1992, the present Company Petition was filed against the Company. Subsequent to the filing of this petition, a reference was filed by the Company before BIFR. The reference was registered as Case No. 46 of 1993. As a result of the reference, the winding up proceedings could not proceed. The Company, however, continued to carry on its business during the pendency of the

reference. During this period, the Company approached the Applicant seeking assistance for procurement of raw material. On 1 December 1994, an agreement was arrived at between the Applicant and the Company, in terms of which the Applicant agreed to supply raw material to the Company upto a certain quantity annually for its manufacturing purposes. The Company agreed to supply yarn to the Applicant at market rates less quantity based discounts as applicable. Between December 1994 and May 1995, the Applicant procured and supplied raw material, namely, caprolactam, worth about Rs. 2.43 crores to the Company. The Company, however, supplied nylon yarn worth only Rs. 1.56 crores to the Applicant. As a result of the mounting credit, the Company agreed to pledge 14,99,988 equity shares of Rs. 10 each held by the Company in Global Offshore Shipping Ltd. ("GOSL") as a security, against which the Company requested the Applicant to "continue supplying Caprolactam to us as you have been doing so". Under this agreement, there was a right of redemption in the Applicant in case of failure on the part of the Company to make payment of its dues. On 31 May 1995, this pledge agreement with a right of redemption was duly recorded in the Minutes of the Meeting of the Board of Directors. Following this, the Applicant also wrote to the GOSL confirming its lien on 14,99,988 equity shares of GOSL owned by the Company. GOSL, by its letter dated 9 April 1996, confirmed its having noted the Applicant's lien in respect of the subject shares. Between May 1995 and August 1996, the Applicant supplied raw materials and also made payments to some of the key contractors of the Company. Around August 1996, the Company stopped its operations and ceased its business. Thereafter, on 31 December 1996, upon reconciliation of the accounts, the Applicant called upon the Company to clear the outstanding dues of about Rs. 1.13 crores payable by the Company to the Applicant on account of supply of raw materials and payment to critical parties/contractors. The Company, by its letter dated 3 January 1997, requested the Applicant to further support the Company in its working capital requirements, against which it offered to transfer 2,21,420 shares of GOSL held by the Company to the Applicant, thereby seeking to reduce the outstandings substantially. In pursuance of this offer, which was accepted by the Applicant, the Company, by a letter dated 14 January 1997, forwarded duly signed Transfer Deeds along with share certificates of 2,21,420 shares of GOSL. On 27 January 1997, these shares were duly transferred to the Applicant, such transfer having been recorded in the Register of Members of GOSL. Subsequent to this transfer, on 28 February 1997 the shares were sold by the Applicant. (Even this transfer is duly recorded). In spite of such transfer and considering the further critical payments by the Applicant on behalf of the Company, a sum of Rs. 93,47,725/- was still outstanding and payable by the Company to the Applicant. The Applicant, in the premises, called upon the Company to transfer the ownership of the pledged shares at their current market value to the Applicant. (The current value at that date was of Rs. 82,49,934/-.) On 17 May 1997, the Company confirmed the transfer of 14,99,998 equity shares of GOSL to the Applicant for a consideration of Rs. 82,49,934/-. (Even after this transfer, an amount of Rs. 10,97,791/- was till outstanding and owed by the Company to

the Applicant.) Following this transfer, the Applicant wrote to the Share Department of GOSL about its acquisition of ownership of the pledged shares. Sometime thereafter, on 29 May 1997, BIFR addressed a communication to the Registrar of this Court recording an opinion that it was just and equitable and in larger public interest to wind up the Company. On 2 June 1997, the Company forwarded duly executed Transfer Deed along with 14 Share Certificates covering 14,99,988 equity shares of GOSL to the Applicant. Subsequently, on or about 5 September 1997, a Provisional Liquidator was appointed by this Court in the present Company Petition in respect of the Company. On 18 October 1997, the Applicant wrote to the Provisional Liquidator putting him to notice that the Applicant was enforcing its option to transfer the subject shares to its name. Thereafter, on 18 December 1998, this Court, pursuant to the BIFR recommendation, permitted the Company to be wound up and directed the Official Liquidator to take charge of the affairs, assets and property of the Company. The transfer of 14,99,988 shares was recorded in the minutes of the Meeting of the Board of Directors of GOSL on 31 January 2006. The explanation for this delay submitted by the Applicant is that the share certificates had been misplaced earlier, around the time of the resignation of its Company Secretary, in May 1997 and were found only in December 2005 and that, thereafter, they were revalidated and lodged with GOSL for registering the transfer. On 6 January 2014, the Official Liquidator submitted a report being OLR No. 179 of 2012. The Official Liquidator's Report was on the footing that the subject transfer of shares was violative of Section 531A of the Act having taken place within six months prior to the commencement of the winding up. Thereupon, the present Company Application was taken out by the Applicant seeking validation of the Pledge Agreement as well as the subsequent invocation of the pledge and transfer of shares in favour of the Applicant.

3. On behalf of the Applicant it is submitted by Mr. Dwarkadas, learned Senior Counsel for the Applicant, that the subject transactions were entered into bona fide and in the ordinary and regular course of business and were in the interest of the Company so as to enable it to continue carrying on its business when its reference was pending before the BIFR. Learned Counsel relies upon the judgment of a learned Single Judge of this Court in Board of Industrial and Financial Reconstruction v. M/s. Hindustan Transmission Products Ltd. 1 in support of his submissions. (This judgment was confirmed in Appeal by a Division Bench of this Court in the case of Sunita Vasudeo Warke Vs. Official Liquidator and Others, (2014) 4 ALLMR 308 : (2013) 2 MhLj 777 Learned Counsel further submits that the pledge, which was created bona fide and for the benefit of the Company, was validly invoked under Section 176 of the Contract Act, 1872 and the transfer of shares was made validly in pursuance of such invocation. Learned Counsel relies upon the cases of Mathalone Vs. Bombay Life Assurance Co. Ltd., AIR 1953 SC 385 : (1954) 24 CompCas 1 : (1954) 1 SCR 117 , Dhani Ram and Sons Vs. Frontier Bank Ltd., New Delhi and Another, AIR 1962 P&H 321 : (1962) 1 ILR (P&H) 79 and Commissioner of Income-Tax, Madurai v. M. Ramaswamy

Company Law Cases 1985 57 page 7 in support of his submissions. On the other hand, it is submitted by Mr. J.P. Sen, learned Senior Counsel appearing for the Official Liquidator, that there are three separate transactions in the present case, namely, (i) pledge of 14,99,998 shares, (ii) transfer of 2,21,420 shares and (iii) transfer of 14,99,998 shares, effected on different dates and in that order. It is submitted that each of these transactions must satisfy the test of Section 536(2) of the Act. Secondly, it is submitted that there was no necessity for these transactions and no corresponding benefit to the Company and what these transactions have effectively done is converting an unsecured creditor (i.e. the Applicant) into a secured creditor in fraudulent preference. Learned Counsel further submits that an incomplete transaction cannot be completed subsequent to an order of winding up, since after a winding up order, all creditors of the Company in liquidation acquire a right to have the assets realized and distributed amongst them *pari passu*. Learned Counsel relies upon the judgment of the Division Bench in the case of Sunita Vasudeo Warke (*supra*).

4. Though the Official Liquidator's Report was initially presented on the footing that the transaction offends the provision of Section 531A of the Act, this ground has since been given up by the Official Liquidator. The contest is now under Section 536(2) of the Act.

5. As provided under Section 536(2) of the Act, any disposition of the property of a company made after the commencement of winding up, is void unless the court otherwise orders. As held by the learned Single Judge of our Court in the case of Hindustan Transmission Products Ltd. (*supra*), for seeking validation of a transfer under Section 536(2), an Applicant must plead and prove not only that the transfers were *bona fide* but also that the transfer was in the interest of the Company. The observations of the learned Single Judge in that case are quoted below:--

"19. Even in a case where the transfer is complete, a further question that arises for consideration is whether for a transfer to be validated under Section 536(2) of the Act, the Applicant must plead and prove not only that the transfer is *bona fide* but also that the transfer was in the interest of the Company. Section 536(2) of the Act provides that any disposition of property made after commencement of winding up shall, unless the Court otherwise orders, be void. Some of the situations in which a transfer may be validated under Section 536(2) of the Act were enumerated in the judgment of a Division Bench of this Court in *Tulsidas Jasraj Parekh v. Industrial Bank of Western India* (*supra*). While sounding a note of caution that - "the discretion confided to the Court cannot be crystallized in rules of law in view of the varying circumstances of human action" - the Court held that it would not permit transactions *bona fide* entered into in the ordinary course of trade and completed before the date of the winding up order to be annulled. In respect of transactions which were not in the ordinary course of trade, the principles that would govern the exercise of discretion under Section 536(2) were summarized in the judgment of the Calcutta High Court in *J. Sen*

Gupta (Pvt.)Ltd. (supra) as follows:

- "1. The Court has an absolute discretion to validate a transaction.
2. This discretion is controlled only by the general principles which apply to every kind of judicial discretion.
3. The Court must have regard to all the surrounding circumstances, and if from all the surrounding circumstances it comes to the conclusion that the transaction should not be void, it is within the power of the Court under Section 536(2) to say that the transaction is not void.
4. If it is found that the transaction was for the benefit of, and in the interests of, the company or for keeping the company going or keeping things going generally, it ought to be confirmed."

The principle that a transfer must be in the best interests of the Company to be validated under Section 536(2) was also reaffirmed in the judgment of this Court in *Kanchan Kumar Dhar, Official Liquidator v. Dr. L.M. Visrani and others* (supra), where Parekh, J. observed:

"The question is not whether Respondent No. 1 acted bona fide or he was a victim of a deception or a fraud practiced on him by the Company. The question is whether the transaction in question is in the interest of the business of the Company or in the interest of the Company (now in liquidation) or its creditors."

6. Applying these tests, we have to now see whether the impugned transfer is within the principles laid down by this Court for validation of transfer. Though there are three transactions in the present case, the transactions of (i) creation of the pledge and (ii) its subsequent enforcement by transfer of shares should be viewed as one composite transaction. The original right in favour of the pledgee was created by an agreement of pledge. Its subsequent enforcement cannot be separately questioned unless such enforcement is contrary to the terms of the pledge. Considering the present agreement of pledge and its enforcement in the light of this, what transpires on the record of the case is that between December 1994 and August 1996, the Applicant agreed to pay for the supply of raw material, i.e. caprolactam, to the Company in consideration of the Company agreeing to supply finished yarn. This agreement appears to be in the ordinary course of the Company's business and bona fide in the interest of the Company. Had it not been for this agreement, the business of the Company would have ceased in 1994-95 itself. The agreement of pledge is very much a part of this agreement. It was entered into in May 1995 in the circumstances noted above. In view of the agreement of pledge, the Applicant continued to supply raw materials and make payments to critical contractors of the Company between May 1995 and August 1996. This ensured further continuance of the Company's operations and business. If any agreement is effected with the Company for ensuring continuous supply of raw materials and continuance thereby of its operations and business during the period the Company's reference is pending

before BIFR and all the stakeholders are interested in the revival of the Company, such agreement can certainly be termed as an agreement in the ordinary business and bona fide in the interest of the Company. As a matter of fact, the Official Liquidator has not joined issues with any of these facts nor does the Official Liquidator in terms impugn the initial transaction of pledge of shares. Evidently, it was in pursuance of this agreement of pledge that the Applicant continued to finance the raw material supply to the Company and also continued to pay the dues of various critical parties for ensuring the continuation of the Company's business. Once the original pledge is held to be valid, its subsequent enforcement being within the terms of the pledge (the Company admittedly having failed to pay the dues of the Applicant), the subsequent transfer of shares in favour of the Applicant cannot be faulted on the ground that it amounts to a fraudulent preference or invalid transfer during the pendency of the winding up. Under Section 176 of the Contract Act, a pledgee is entitled in the event of a default of the pledgor to retain the goods pledged as a security or at its option, to bring the property pledged to sale with notice to the owner. The Official Liquidator does not question the fact of non-payment of the Applicant's dues by the Company in pursuance of the agreement of pledge and, in the premises, the subsequent enforcement of the pledge by effecting a transfer of shares in favour of the Applicant cannot be faulted.

7. Even as regards the transaction of transfer of 2,21,420 shares of GOSL, the transfer in effect is a payment made by the Company to the Applicant towards its dues incurred for business transacted pending the reference before the BIFR and, in the circumstances, more particularly noted above, it is very much a transaction effected in the course of the Company's business and for the benefit of the Company.

8. Mr. Sen, learned Senior Counsel appearing for the Official Liquidator, relied on the judgment of the Division Bench in *Sunita Vasudao Warke* (supra) and submitted that even if the pledge in favour of the Applicant was valid when created, the transfer effected subsequent to the winding up order in favour of the Applicant was still void, since after the winding up order no new rights could be created or no incomplete rights could be completed. He submitted that doing so would be contrary to the rights of the creditors as a class to have the proceeds of the assets of the Company in liquidation distributed amongst them *pari passu*. The judgment, no doubt, supports the proposition canvassed by learned Counsel. What, however, needs to be seen is whether there are any new rights created as a matter of fact or whether any incomplete rights are completed in the present case. The agreement of pledge as well as transfer of shares by executing transfer deeds in respect thereof has evidently happened before the winding up order. It is, however, submitted that under Section 108 of the Act, the transfer is not complete unless and until the shares along with duly executed transfer deeds are lodged with the Company and registered in the Register of Members of the Company. It may be that as between both the transferor and transferee on the one hand, and the Company, whose shares are sought to be transferred, on the

other, the transfer may not be complete until the share certificates along with duly executed transfer deeds are lodged with the latter. But as between the transferor and the transferee, the transaction is concluded by the transferor delivering share certificates together with duly executed transfer deeds to the transferee. The mere fact that the share certificates along with duly executed transfer deeds are not lodged with the Company or that such transfers are not registered in the record of the Company does not detract from the completeness of the transfer as between the transferor and the transferee. The Division Bench of Madras High Court in the case of M. Ramaswamy (*supra*) has considered the transfer of shares as between the donor and donee of shares pending completion of formalities of transfer. The Court in that case held as follows:--

"A question arose as to whether, on the facts and in the circumstances of the case, there was a complete transfer of shares even during the lifetime of the donor. The Supreme Court held that the requirements of both Sections 122 and 123 of the Transfer of Property Act, 1882, were completely satisfied so as to vest the right in the donee to obtain the share certificates in accordance with the provisions of the company law, that the gift of the right to get share certificates made out in the name of the donee became irrevocable and complete by registration of the deed as well as by delivery and nothing was left to be done so far as the vesting of such a right in the donee was concerned and that the actual transfers in the registers of the companies concerned, which were necessary to enable the donee to exercise the rights of a shareholder, were mere enforcement of that right, and the mere fact that such transfers had to be recorded in accordance with the company law did not detract from the completeness of what was donated. According to the said decision of the Supreme Court, if the transferor has transferred the right to get the share certificates from the company in the name of the donee, then, as between the transferor and the transferee, the transfer is complete, though the transferee cannot exercise his rights as a shareholder vis-?-vis the company, until the transfer of shares is recorded in the register of shareholders of the company. The aforesaid decision of the Supreme Court practically takes away the force of the contention of the learned counsel for the Revenue that till the shares are actually registered by the company in the name of the transferee, the transferee cannot be taken to have acquired certain equitable rights in relation to his shares and that he cannot be taken to have become the transferee of the shares. As a matter of fact, in the present case, the transfer forms duly signed by the transferor along with the share certificates have been handed over to the transferee and the transferee has sought registration of the transfer in the books of the company. The company has not refused to recognise the transfer, but it has stated that the registers are not immediately available to record the transfer of shares. In these circumstances, the aforesaid decision of the Supreme Court in *Shelat v. Thakar*, directly applies to the facts of this case and, therefore, the decision of the Tribunal cannot be said to be erroneous."

9. Thus, none of the objections of the Official Liquidator has any merit. The

pledge of shares by the Company in liquidation in favour of the Applicant and its enforcement by transfer of the shares and so also, the transfer of other shares effected during the pendency of the winding up, as noted above, are both bona fide and in the interest of the Company in liquidation. Accordingly, the Company Application is made absolute in terms of prayer clauses (a), (b) and (c). In terms of this order the Official Liquidator's Report is disposed of. There shall be no order as to costs. The order of status quo dated 15 December 2014 is vacated.

1OLR No. 145/2011, Coram: S.J. Kathawalla, J. dated 5 September 2012.