

(2009) 11 KL CK 0050

In the High Court Of Kerala

Case No : Company Petition No. 1 of 2009

In Re: Al-ahali Business Trade Links P. Ltd.

Date of Decision : 16-11-2009

Acts Referred:

Companies (Court) Rules, 1959 — Rule 246, 265
Companies Act, 1956 — Section 100, 101, 391, 392, 393

Citation : (2010) 157 CompCas 501

Hon'ble Judges : S. Siri Jagan, J

Bench : Single Bench

Advocate : Philip Mathew, for the Appellant; T.P.M. Ibrahim Khan, A.S.G. of India for Registrar of Companies and P. Gopinatha Menon, Amicus Curiae, for the Respondent

Final Decision : Allowed

Judgement

S. Siri Jagan, J.—This is an application filed by a company to sanction a scheme of compromise and arrangement, entered into by them with the equity shareholders of the company. The compromise and arrangement is on the following terms:

(a) The issued subscribed and paid-up capital of the petitioner-company will stand reduced from Rs. 14,10,00,900 to Rs. 1,41,00,900 and transfer the balance of 90 per cent. of the paid-up share capital of the company amounting to Rs. 12,69,00,810 to the unsecured loan account of the shareholders of the company in proportion to the face value of the respective number of shares held by each shareholder. Only 10 per cent. of the existing value of the equity shareholding as appearing in the books of the company in rupee terms of each shareholder of the company will be kept in the paid-up capital of the company and the balance 90 per cent. of the value of the equity shares holding in rupee terms held by each shareholder will be transferred to his credit in the unsecured loan account of the company. There will be a corresponding reduction of the equity shares held by each shareholder without any reduction of the face value of the equity shares.

(b) By converting 90 per cent. of the existing issued, subscribed and paid-up share capital of the company amounting to Rs. 12,69,00,810 as unsecured loans from respective shareholders, the issued, subscribed and paid-up share capital of the company would stand reduced to one-tenth of the present existing capital of Rs. 1,41,00,090. Consequently, the debt-equity ratio will be brought down from the massive under geared 1 : 9 to 1 : 05 : 1.

(c) Upon coming into force of the scheme, with effect from the appointed date, to the extent of the amount of unsecured loans of respective shareholders arising under this scheme, the same would stand credited to their respective accounts in the books of the company and these loans shall remain with the company for a minimum period of 5 (five) years from the appointed date and shall carry a rate of interest not exceeding 18 per cent. per annum computed with quarterly/monthly rests.

(d) Interest shall be paid to the respective lenders thereon for their respective unsecured loan amounts on a quarterly/monthly basis. Except on compassionate grounds, there shall not be any prepayment of the principal amount standing to the credit of the respective loan accounts of the respective shareholders/lenders maintained by the company. The decision of the board of directors of the company shall be final with regard to the question whether the nature of grounds specified by any particular lender should be considered as a compassionate ground or not.

(e) The conversion of 90 per cent. of the existing issued, subscribed and paid-up capital of the company amounting to Rs. 12,69,00,810 as unsecured loans from respective shareholders, does not impair the liquidity or the trading capacity of the company and none of the creditors would be affected in any manner, whatsoever, by the reconstruction of the share capital. This scheme does not envisage any compromise between the company and its creditors. The scheme does not in any way affect the company's ability to service its loans and its repayment.

2. By an order made on October 28, 2008, in M. C. A. No. 114 of 2008, this Court directed the convening of a meeting of equity shareholders of the company to consider a resolution as to whether the shareholders of the company approved the scheme. Consequently, the advocate chairman appointed by this Court has convened a meeting of the shareholders of the company on December 19, 2008 and filed a report, which has been produced along with the company petition, wherein it is stated thus:

(1) The said meeting was attended personally by 15 (fifteen) members and by proxy numbering 10 (ten) representing the members of the said company entitled together with 62,80,040 equity shares.

(2) The scheme of arrangement under Sections 391 to 394 of the Companies Act, 1956, was read out and explained by me to the meeting and the question submitted to the said meeting was whether the equity shareholders of the said

company approved of the said scheme of arrangement submitted to the meeting as agreed thereto.

(3) The said meeting was unanimously of the opinion that the said scheme of arrangement should be approved and agreed to and the result of the voting upon the said question was as follows.

3. The chairman has reported that the scheme of arrangement proposed by the petitioner-company has been approved by the equity shareholders without any modification. The notice on this company petition was given to the Registrar of Companies as required u/s 394A of the Companies Act, 1956, who has filed objections to the effect that after reducing the share capital, the company proposes to hold the reduced share capital as loans received from the shareholders for which the company would pay to the shareholders interest at a rate not exceeding 18 per cent. The Registrar of Companies submits that as a result of this, there are reciprocal arrangements. There is no cash outflow which should normally be the result of reduction of share capital. He would submit that in the said circumstances, the scheme propounded is not in accordance with law and that the provisions of Section 100 of the Companies Act, 1956, have not been complied with.

4. In view of the issues raised by the Registrar of Companies, this Court appointed advocate Sri P. Gopinatha Menon as amicus curiae to assist the court on the questions of law involved. Accordingly, he has addressed the court on the legal aspects involved in the matter. He points out that the legal position is settled by various decisions to the effect that it is for the company to determine the mode and instance of reduction of the share capital and the duty of the court is to protect the interest of the minority shareholders and creditors. It is not for this Court to look into the motive behind the reduction of the share capital. The question of reduction of share capital has to be treated as a matter of domestic concern on the decision of the majority shareholders of the company. Subject to the necessity of obtaining confirmation of the court, the company is left to choose the mode in which reduction is to be made, namely, the extent of the reduction and all other questions concerning the reduction including the application of the money which may be set free as a result of the reduction. He points out that this question has been elaborately considered by the Madras High Court in *In Re: Panruti Industrial Co. (Private) Ltd.*, wherein after referring to all the decisions on the subject including the English decisions the above conclusions were arrived at by the court. He therefore, points out that the question as what to do with the amounts released on reduction of the share capital is the sole concern of the company and its shareholders and unless this Court comes to a finding that the mode of such reduction is prejudicial to the interest of the shareholders, creditors or the public, it is not for this Court to look into the object behind the application of the released funds. But he points out that this being a reduction of the share capital the procedure prescribed u/s 100 of the Companies Act should have been followed and not the procedure prescribed under Rules 246

and 265 of the Companies (Court) Rules, 1959, as applicable to sanction of a scheme of compromise or arrangement. He points out that the petitioner has followed the procedure prescribed for sanction of compromise or arrangement under Sections 391 and 394 of the Companies Act which may not be technically correct.

5. Counsel for the petitioner submits that in view of the fact that the reduction of the share capital was with a further reciprocal arrangement with the shareholders that the money released on reduction of the share capital shall be held by the company as a loan to the company by the shareholders, the same is a compromise or arrangement between the company and its shareholders and not a reduction of share capital simpliciter. Therefore, he contends that the petitioner has rightly followed the procedure prescribed under Rules 246 and 265 of the Companies (Court) Rules, 1959, for obtaining sanction of the court under Sections 391 and 394 of the Companies Act.

6. I have considered the issues involved in this company petition.

7. I shall first deal with the question as to whether it was proper on the part of the petitioner to seek sanction for reduction of the share capital u/s 100 of the Companies Act as a compromise or arrangement under Sections 391 and 394 of the Act. As rightly pointed out by Counsel for the petitioner, what is involved here is not merely reduction of the share capital. If it was a mere reduction of the share capital the released capital has to be returned to the shareholders. Instead of refunding the money released on reduction of the share capital, the company has entered into a compromise or arrangement with the shareholders of the company to retain the money so released as unsecured loans from the shareholders to the company, on which the company is to pay interest to the shareholders at a rate not exceeding 18 per cent. per annum computed at quarterly/monthly rests. Reduction of such share capital and conversion thereof as unsecured loans is a composite transaction for which sanction of this Court is sought for. If merely the procedure prescribed under Sections 100 and 101 of the Companies Act is to be complied with, then the second part of the transaction cannot be considered along with the first part. The second part is essentially a compromise or arrangement with the shareholders. The two being reciprocal arrangement, both together can be considered as a compromise or arrangement under Sections 391 and 394 of the Companies Act. Nobody would be prejudiced if both are considered together under Sections 391 and 394 of the Companies Act. The petitioner has complied with the procedure prescribed for the same. In fact there is substantial compliance with the requirements for sanction of both reduction of share capital as well as the scheme of compromise and arrangement. Therefore the procedure adopted by the petitioner by seeking sanction of reduction of share capital and the reciprocal arrangement with the shareholders for conversion of the released share capital as unsecured loan, under Sections 391 and 394, is perfectly in order.

8. Regarding the other issue raised by the Registrar of Companies, as pointed out

by Sri P. Gopinatha Menon, the amicus curiae appointed by the court in this case, the entire gamut of the judicial precedents, both Indian and English has been discussed by the Madras High Court in *In Re: Panruti Industrial Co. (Private) Ltd.*, . The principles discernible therefrom on the question of law involved may be summarised as follows:

A company has power to reduce the share capital subject to confirmation by the court. The issue of reduction of share capital is a domestic one to be decided by the shareholders by majority. It is for the company to determine the extent, mode and incidence of the reduction including the application of the moneys which may be set free as a result of the reduction. The duty of the court is only to protect the interest of the minority shareholders and creditors and see whether the reduction of the share capital affects them prejudicially. The court will also consider whether the sanction ought to be refused out of regard to the interests of members of the public who may be induced to take shares in the company and whether the reduction is fair between classes of shareholders. But the courts should be slow to interfere with the decision of the shareholders acting honestly and who are usually better judges of what is to their commercial advantage than the court. The court has the discretion to sanction any reduction which is fair and equitable, which has to be exercised on the basis of accepted principles. But subject to the court's discretion, any loss is to be borne among the members in such manner as a loss in respect of capital is to be borne under the constitution of the company, and if money is to be returned, it is to be returned in the same way as capital is returnable. Where a reduction process to pay off one class of shareholders, e.g., preference shareholders, the fact that that class might have obtained a future benefit beyond what they will receive on reduction does not in itself render the scheme inequitable. When exercising discretion in such matters, the court is concerned to see that the reduction is fair and equitable, but is not concerned to consider the motive for the reduction, as for example, that it was to avoid the effects of a threatened nationalisation or to distribute accumulated profits in such a way as to avoid or diminish liability to tax or to provide for the payment of estate duty on the death of the large shareholders. The company is not bound to satisfy the court that the proposals are not unfair and it is for the objectors to disclose such matters as will stand in the way of the court's approval.

9. Tested on the anvil of the above settled principles of law, on the facts of this case, I have no reason to decline to exercise my discretion or to modify the scheme in any manner. No ground has been brought to my notice to deny relief to the petitioner. There is no reason to hold that the shareholders or creditors would be prejudicially affected or that the reduction is not fair or equitable. Accordingly the reduction of the paid-up share capital of the company by Rs. 12,69,00,810 and conversion of the same as unsecured loans from the respective shareholders is confirmed as approved by the shareholders by resolution dated December 19, 2008 and the reduction of share capital and the compromise and arrangement with the shareholders are hereby sanctioned

without any modification.

10. The sanctioned scheme of arrangement and compromise with the shareholders shall be published in one issue of Mathrubhumi daily and one issue of Indian Express daily in their editions having circulation in and around Thrissur within two weeks after registration of the same with the Registrar of Companies, for which purpose a certified copy of this order shall be delivered to him within 21 days from today. Publication in the Official Gazette is dispensed with. The company petition is allowed as above. The registry shall issue order in the appropriate form prescribed under the Companies (Court) Rules, 1959.

11. This judgment would not be complete without a word of appreciation for the efforts put in by the amicus curiae. In view of the fact that there are no objectors to the company petition apart from the Registrar of Companies, I had requested advocate Sri P. Gopinatha Menon to assist the court as amicus curiae. He, despite his pre-occupation with his own work, accepted the assignment and worked up the position of law with great alacrity and enlightened the court on every aspect of the issues involved. But for his efforts, this judgment would not have been in the shape that it now is. I place on record the appreciation and gratitude of the court for his selfless devotion to the court, which he richly deserves.

12. The company petition is allowed as above.