(2009) 12 AP CK 0011

In the Andhra Pradesh High Court

Case No : Company Petition No. 79 of 2009 and Company Application No. 340 of 2009

In Re : Aurobindo Pharma Ltd.

Date of Decision : 31-12-2009

Acts Referred:

Companies (Court) Rules, 1959 — Rule 46, 47, 48, 49, 50
Companies Act, 1956 — Section 100, 103, 104, 210(2), 211
Foreign Exchange Management (Transfer of Issue of any Foreign Security) (Amendment) Regulations, 2004 — Regulation 21(2), 4, 46
Foreign Exchange Management Act, 1999 — Section 10(4), 11(1)
Income Tax Act, 1922 — Section 10(2)

Citation : (2011) 167 CompCas 458 : (2011) 105 SCL 717

Hon'ble Judges : V.V.S. Rao, J

Bench : Single Bench

Advocate : S. Ravi, for the Appellant; Anil Kumar, for the Official Liquidator, for the Respondent

Final Decision : Dismissed

Judgement

V.V.S. Rao, J.—This petition under Sections 391 to 393, read with Sections 100 to 103, of the Companies Act, 1956, and Rule 79 of Companies (Court) Rules, 1959 (the Rules, for brevity) is filed by M/s. Aurobindo Pharma Limited (hereinafter, Aurobindo) praying for sanction of Scheme of Arrangement between company and its shareholders. The Scheme of Arrangement concerns with two aspects, namely, (i) utilizing an amount of Rs. 91 crores standing to the credit of ''Capital Redemption Reserve'' (CRR) towards adjusting the expenses enumerated in Clause 1.5 of the Scheme; and (ii) creation of ''Reconstruction Reserve Account'' (RRA) by transferring/ crediting an amount of Rs. 90.30 million standing to the credit of ''Capital Reserve'' and the benefits accruing from buy-back of ''Foreign Currency Convertible Bonds'' (FCC Bs) and for utilizing ''RRA'' for all or any of the expenses as enumerated in Clause 1.5, which reads as under:

1.5 "Expenses" means and without limiting the generality of the foregoing, includes, inter alia, the following items accounted for in the financial statements of Aurobindo:

1.5.1 Amount to be written off towards obsolete or unrealizable assets, whether tangible or intangible or fixed or current;

1.5.2 Any unrealizable loans and/or advances, whether recoverable in cash or in kind, whether belonging to Aurobindo or its Subsidiaries and arising on preparation of stand alone and/or Consolidated Financial Statements of Aurobindo;

1.5.3 Interest and other financial charges receivable and outstanding for such period as may be determined by the Board on loans/ advances made to subsidiaries;

1.5.4 Impairment, amortization and/or write off of goodwill;

1.5.5 Diminution in the value of investments in subsidiary companies and/or Joint Ventures of Aurobindo and/or any of its subsidiaries and consequent impairment of goodwill and accumulated losses of such subsidiaries on consolidation, in the financial Statement of Aurobindo;

1.5.6 Impairment/diminution/realization losses, if any on investments other than as mentioned in Clause 1.5.5 above, whether current or long-term or quoted or unquoted, or trade or non-trade;

1.5.7 Such other expenses, cost, impairments, write offs and diminution, as considered necessary by the Board from time to time;

1.5.8 For the purposes of this clause, if any issue/question arises with respect to identification and/or qualification of the nature and amount of the expenses, the decision/clarification of the Board shall be final.

Background of the Scheme

2. Aurobindo is a company registered under the Companies Act. Its authorized share capital is Rs. 500 million consisting of 100 million equity shares of Rs. 5 each and one million preference shares of Rs. 100 each. 53,765,268 equity shares of Rs. 5 each have been issued, subscribed and paid-up amounting to Rs. 268.80 million. These shares are listed on National Stock Exchange Limited and Bombay Stock Exchange Limited. Aurobindo is in the business of manufacturing, marketing, chemicals, intermediaries, drugs, formulations, dyestuffs etc. The Board of Directors in their meeting held on 31-3-2009 allegedly passed resolution approving the Scheme of Arrangement between the company and its shareholders to utilize the amounts standing in the credit of CRR as on 31-3-2008 towards expenses of the company especially those expenses as enumerated in Clause 1.5 of the Scheme and/or transferring the said amount as well as the benefits accruing from buy-back of FCC Bs to RRA towards adjusting expenses as referred to hereinabove. The details of these two aspects of the Scheme are as below.

3. Aurobindo issued 12.5 per cent redeemable non-convertible preference shares to an extent of Rs. 50 lakhs (50,000 shares of Rs. 100 each) during the financial year 1997-98 to Canara Bank. For the financial year 1998-99, the company issued preference shares to an extent of Rs. 4,50,00,000 (4,50,000 preference shares of Rs. 100 each) on 17-11-1998 to SBI Capital Marks Limited, Mumbai; and preference shares to an extent of Rs. 4,00,00,000 (4,00,000 preference shares of Rs. 100 each) to Global Trust Bank Limited, Mumbai on 24-11-1998. These are redeemable on 17-5-2000 and on 24-5-2000 respectively. The company purporting to comply with Section 80(1)(d) of the Companies Act credited out of its profit to CRR during the period commencing from financial years 1997-98 to 2000-01. The details of amounts credited to CRR from out of profits is as follows:

Sl. No. Financial Year ending in 31st March Amount credited (in 000s)

1. 1998 46.58

2. 1999 13,388.13

3. 2000 65,475.29

4. 2001 11,090.00

Total 90,000.00

4. After transferring amounts to CRR in four financial years, Aurobindo redeemed preference shares allotted to Canara Bank on 20-12-2000. The shares allotted to SBI Capital Markets and Global Trust Bank were redeemed on 17-5-2000 and 25-5-2000 respectively. To that effect, the company also filed Form No. 5 in accordance with Sections 95, 97, 97A(2) and 81(4) of the Companies Act with the Registrar of Companies (RoC).

5. To meet financial requirements, Aurobindo issued FCC Bs twice in 2005-06 and 2006-07. The first of these two issues is for 60 million US$ due on 2010 convertible into ordinary shares of Aurobindo. The second one was in two tranches. Tranch A is for US$ 150 million and tranch B is Rs. 50,000,000. The first issue is redeemable on 11-8-2010 and the second issue is redeemable on 11-8-2010 and on 17-5-2011. Reserve Bank of India (RBI) issued policy directions vide A.P. (DIR Series) Circular No. 39, dated 8-12-2008 under Sections 10(4) and 11(1) of the Foreign Exchange Management Act, 1999 (FEMA) for buy-back/per payments of FCC Bs at a discount of 15 per cent or 25 per cent as the case may be. The Companies were required to complete the buy-back by 31-3-2009. By yet another Circular No. 58, dated 13-3-2009, the time has been extended up to 31-12-2009 for the purpose of buy-back at a discounted price. Stately, RBI allowed buy-back at a discounted price as market value of Indian Companies were downgraded due to global economic situation. Aurobindo availed opportunity and bought back FCC Bs at a discount to face value in the open market and appears to have reaped considerable benefit by such buy-back of FCC Bs. As a part of Financial Restructuring Exercise (FRE), Aurobindo proposed

to utilize capital reserve of Rs. 90 million allegedly outstanding as on 31-3-2008 as well as the benefit arising from buy-back of FCC Bs on discount for the purpose of meeting expenses at the discretion of Board.

6. Aurobindo moved an application before the High Court under Sections 391 to 393, read with Sections 100 to 103, of the Companies Act praying this Court to pass an order to convene the meeting of equity shareholders for the purpose of considering the scheme. The application being Company Application No. 340 of 2009 was ordered and an advocate was appointed as Chairperson to convene the meeting of shareholders. Accordingly, meeting was convened on 21-5-2009 at the place designated by the Court. After doing so, Chairperson filed a report. The meeting was attended (out of 45,300) by 109 members (76 persons, 27 proxies and 6 corporate members). In the meeting held by chairperson, members representing 3,49,87,258 number of shares of Rs. 5 each, 94.50 per cent (103 members) with Rs. 3,28,68,148 (93.92 per cent) voted in favour of resolutions which were considered.

7. Aurobindo statedly has eight secured creditors, namely, Andhra Bank, Canara Bank, ICICI Bank, IDBI Bank, HDFC Bank, State Bank of Hyderabad, State Bank of India and Standard Chartered Bank. It appears all of them accorded consent for creation of RRA. Insofar as unsecured creditors are concerned, Aurobindo perceives that they will not be affected adversely with the proposed Scheme because post-Scheme assets will be sufficient to discharge the liabilities. Aurobindo also obtained no objection letters to the proposed Scheme from Bombay Stock Exchange and National Stock Exchange. Therefore, this application is filed under Sections 391 to 393, read with Sections 100 to 103, of the Companies Act. This Court ordered notice to Central Government while directing publication of notice of hearing in two newspapers. Aurobindo''s counsel took out notice and also served papers on Central Government ie., Regional Director, Department of Company Affairs, Chennai. No objections have been received by the Court nor did any person appear when the matter was heard. The Registrar of Companies (RoC) purporting to act under authorization issued by Regional Director of Department of Corporate Affairs filed an affidavit stating that Central Government decided not to make any objection to the proposed Scheme.

8. This Court heard learned Counsel for Aurobindo on 7-7-2009 and 8-7-2009 and reserved the Orders. Again, the matter was directed to be listed ''For Being Mentioned'' for certain clarifications on 20-7-2009 and 27-7-2009. The counsel reiterated the principles governing the cases under the Companies Act which require sanction/approval of the Court like scheme of compromise/arrangement or financial reconstruction or a scheme of amalgamation.

Court''s power to sanction Scheme

9. It is settled that in all such cases the Court does not exercise its appellate powers or review powers. It cannot sit in appeal over Scheme of Arrangement

between the company, its members and creditors. Court in a way acts as a ''Corporate Ombudsman'' to ensure that the Scheme of Arrangement/ compromise among the company, its members and creditors is fair and just and does not subvert public interest or breach law. In Miheer H. Mafatlal v. Mafatlal Industries Ltd. 1996 87 Comp. Cas. 79110 SCL 70, Supreme Court considered the scope of power vested in Court while dealing with ex parte applications and petitions under the Companies Act and Companies Rules seeking sanction/ approval of the Court for the Scheme of Arrangement. Referring to Hindustan Lever Employee''s Union v. Hindustan Lever Ltd. 1995 2 SCL 157 (SC), the following principles were laid down:

1. The sanctioning Court has to see to it that all the requisite statutory procedure for supporting such a scheme has been complied with and that the requisite meetings as contemplated by Section 391(1)(a) have been held.

2. That the scheme put up for sanction of the Court is backed up by the requisite majority vote as required by Section 391(2).

3. That the concerned meetings of the creditors or members or any class of them had the relevant material to enable the voters to arrive at an informed decision for approving the scheme in question. That the majority decision of the concerned class of voters is just and fair to the class as a whole so as to legitimately bind even the dissenting members of that class.

4. That all the necessary material indicated by Section 391(1)(a) is placed before the voters at the concerned meetings as contemplated by Section 391(1).

5. That all the requisite material contemplated by the proviso to Sub-section (2) of Section 391 of the Act is placed before the Court by the concerned applicant seeking sanction for such a scheme and the Court gets satisfied about the same.

6. That the proposed scheme of compromise and arrangement is not found to be volatile of any provisions of law and is not contrary to public policy. For ascertaining the real purpose underlying the scheme with a veil to be satisfied on this aspect. The Court, if necessary, can pierce the view of apparent corporate purpose underlying the scheme and can judiciously X-ray the same.

7. That the company Court has also to satisfy itself that members or class of members or creditors or class of creditors, as the case may be, were action bona fide and in good faith and were not coercing the minority in order to promote any interest adverse to that of the latter comprising the same class whom they purported to represent.

8. That the scheme as a whole is also found to be just, fair and reasonable from the point of view of the prudent men of business taking a commercial decision beneficial of the class represented by them for whom the scheme is meant.

9. Once the aforesaid broad parameters about the requirement of a scheme for getting sanction of the Court are found to have been met the Court will have no

further jurisdiction to sit in appeal over the commercial wisdom of the majority of the class of persons who with their open eyes have given their approval to the scheme even if in the view of the Court there could be a better scheme for the company and its members or creditors for whom the scheme is framed. The Court cannot refuse to sanction such a scheme on that ground as it would otherwise amount to the Court exercising appellate jurisdiction over the scheme rather than its supervisory jurisdiction. [Emphasis supplied]

10. The question that often confronts the Court is whether it can decline approval/sanction to a Scheme of Arrangement, even when the majority of members approved the scheme in the Court convened meeting and all the creditors gave their consent for the scheme. There cannot be any doubt that even in such a case, the Court can refuse its approval if such scheme is found to contravene the law. The Court can reject sanction if the scheme is found to have been conceived with ulterior motive of playing fraud on public authorities. The Court can also withhold its imprimatur if it is found that in the long run such scheme is not in the interest of its members, creditors, employees and subverts public interest. Needless to mention that the Court can always throw out the scheme if it is intended to legitimize the lapses and illegalities that crept into the corporate governance for which persons at the helm of affairs of the company are alone responsible. Lastly if the Scheme of Arrangement is an inchoate transaction affecting future, the Court can always refuse sanction.

11. In British & American Trustee & Finance Corporation v. John Couper 1894 AC 399 (HL), the importance and sanctity of curial sanction to a Scheme of Arrangement was explained by House of Lords in a case wherein the Scheme of Arrangement envisaged reduction of capital by paying off the shares of one group of members was approved observing as under:

I do not see any danger in the conclusion that the Court has power to confirm such a scheme as that now in question, or any reason to doubt that this was the intention of the Legislature. The interests of creditors are not involved, and I think it was the policy of the Legislature to entrust the prescribed majority of the shareholders with the decision whether there should be a reduction of capital, and if so, how it should be carried into effect. The interests of the dissenting minority of the shareholders (if there be such) are properly safeguarded by this: that the decision of the majority can only prevail if it be confirmed by the Court.

12. Thus, the law providing for Court sanction for scheme is a safeguard against ultra vires corporate excesses and is intended to subserve public interest. Of late, the corporate world derives abundant sustained strength by State support which comes by way of direct/indirect financial participation, subsidized infrastructural facilities, continuous flow of supplies of human resources and sovereign guarantees where international finances are involved. Therefore, even though the Court ought to view the Scheme of Arrangement submitted for approval with deference to the wishes of proposers and members, nevertheless the Court should be cautious not to be swayed by approval of imposing majority. All

decisions of majority at all times cannot be presumed to be legal or legitimate, and corporate leadership cannot always be presumed to be correct in absolute terms. The Court when called upon to examine a scheme for the purpose of according sanction, must therefore keep in view not only the subject matter before it but also look to effect of its decision on the future corporate arrangements.

Reduction of Share Capital vis-a-vis Capital Redemption Reserve

13. Capital includes ''share capital'' which may again comprise equity share capital and preference share capital (Sections 85 and 86 of Companies Act). In addition to this, the reserve account created by the company from out of its profits earned also forms part of capital. A perusal of the provisions in Part IV Schedule I and Schedule VI would show that the capital of the company consists of mainly shareholders'' funds which include capital, reserves and surplus. When the share capital together with reserves/surplus is found to be in excess of requirements of the company, it would certainly be an unwise business proposition to carry on business with such surplus capital. Therefore, the company, if its Memorandum and Articles so authorize, can reduce its share capital.

14. Companies Act primarily recognises three modes of reduction of share capital. Regulation 46 of the Regulations for management of a company limited by shares (Table A Schedule I) provides that a company may by special resolution reduce in any manner (I) its share capital; (ii) any capital redemption reserve account; or (iii) any share premium account. Section 100(1) indicates three ways of reducing its share capital. These are (i) by extinguishing or reducing liability in respect of unpaid share capital; (ii) by cancelling paid-up share capital which is lost or unrepresented by available assets; or (iii) by paying off any paid-up share capital which is in excess of wants of the company. Needless to mention that any resolution of the company to reduce share capital in any of the three ways needs confirmation of the Court which is required to follow the procedure contemplated in Sections 100 to 104 the Companies Act and Rules 46 to 65 of the Companies (Court) Rules.

15. In addition to the reduction of share capital as contemplated by Section 100 of the Companies Act, the company can also reduce its share capital in other two ways. Until recently, law barred a company from purchasing its own shares. Section 77 of the Companies Act prohibits a company to buy its own shares unless consequent reduction of capital is effected and sanctioned in pursuance of Sections 100 to 104 of the Companies Act. By Companies (Amendment) Act, 1999, with effect from 31-10-1998, Parliament inserted Sections 77A, 77AA, and 77B. u/s 77A, which is an exception to Section 77, a company may purchase or buy-back its own shares out of its free reserves or securities premium account or proceeds of any shares or any other specified securities not exceeding 25 per cent or total paid-up equity capital in a financial year. It is now well accepted that the companies decision to purchase or buy-back its own shares from out of free

reserves or share premium account is "an indirect method of reducing capital of the company" (See Traver v. Witworth [1887] 12 AC 409 (HL) and Ramesh B. Desai v. Bipin Wadilal Mehta [2006] 69 SCL 211 (SC).

16. In addition to reduction of capital by buy-back of shares, law also contemplates yet another method of reduction of share capital. This is by way of a deemed provision, which creates a fiction as if it amounts to reduction of share capital. Here it is necessary to refer to power of the company to issue redeemable preference shares and method of redeeming such preference shares. For ready reference, Section 80 of the Companies Act to the extent relevant [comitting Sub-sections (2), (4), (5A) and (6)], is extracted below:

80. Power to issue redeemable Preference Shares.--(1) Subject to the provisions of this section, a company limited by shares may, if so authorized by its articles, issue preference shares which are, or at the option of the company are to be liable, to be redeemed:

Provided that--

(a) no such shares shall be redeemed except out of profits of the company which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares made for the purposes of the redemption;

(b) no such shares shall be redeemed unless they are fully paid;

(c) the premium, if any, payable on redemption shall have been provided for out of the profits of the company or out of the company''s security premium account, before the shares are redeemed;

(d) where any such shares are redeemed otherwise than out of the proceeds of a fresh issue, there shall, out of profits which would otherwise have been available for dividend, be transferred to a reserve fund, to be called the capital redemption reserve account, a sum equal to the nominal amount of the shares redeemed; and the provisions of this Act relating to the reduction of the share capital of a company shall, except as provided in this section, apply as if the capital redemption reserve account were paid-up share capital of the company.

(3) The redemption of preference shares under this section by a company shall not be taken as reducing the amount of its authorized share capital.

(5) The capita] redemption reserve account may, notwithstanding anything in this section, be applied by the company, in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares.

17. The provision deals with power of a company to issue and redeem preferential shares. Unless and until the Articles of Association, of a company permit to do so, preferential shares cannot be issued. Even if the preferential shares are issued, they have to be redeemed within a stipulated period. There cannot be any doubt that the amount, which the company gets by issue of preferential shares forms part of the capital of a company. It is very interesting

as to how the law enables redemption of preference shares. The proviso to Sub-section (1) of Section 80 of the Companies Act contemplates the redemption of fully paid preference shares in two ways, namely, (i) from out of the proceeds of fresh issue of shares made for the purpose of redemption; and (ii) from out of distributable profits. Sub-section (3) of Section 80 of the Companies Act is to the effect that redemption of preference shares shall not amount to reducing the amount of its authorized share capital. So to say, if fresh issue of shares is made even if such proceeds of fresh issue of shares are utilized for redemption of preference shares, it shall not be treated as reducing the authorized share capital. However, if the company redeems fully paid-up preference shares from out of the profits, it is required to follow the procedure applicable for reduction of share capital.

18. Section 80(1) read with its proviso, especially Clauses (a) and (d) thereof is to the effect that when shares are redeemed out of distributable profits, the company is required to follow two things, namely, (i) to create and transfer to (from out of profits) Capital Redemption Reserve (CRR) and (ii) to do so, follow the provisions of the Companies Act relating to reduction of share capital. It may look little odd that when the proceeds of fresh issue of shares are utilized for redemption of preference shares, provisions relating to reduction of share capital are not applied but when distributable profits are utilized for reduction of the preference shares, the provisions relating to reduction of share capital are applied. The intention of Legislature appears to be the following. When the preference shares are to be redeemed from out of the fresh issue of share capital, the company is required to issue such fresh issue of shares specifically mentioning the purpose of such fresh issue, namely, redemption of preference share capital. However, when the profits are earned and for the purpose of compliance with the statute, portion of the profits are transferred to general reserve or statutory reserve, as the case may be, no reduction of capital is involved. The profits are ordinarily intended for various appropriations including distribution of dividends. When once a portion of the profits are intended to be used for redemption of preference shares, it results in reducing the profits available for distribution and transfer to other reserve and thereby there is reduction of capital. There cannot be any doubt that undistributed profits available to the company and its shareholders form part of balance sheet but when once funds are transferred to CRR as per Section 80(1) proviso (d) of the Companies Act, there is reduction of capital.

19. What is the stage at which a company is required to obtain sanction? Is it at the stage of transferring from out of the profits to CRR or at the time of redemption of preference shares utilizing the funds available in CRR? A plain reading of Section 80(1)(d) of the Companies Act would make it clear that the company is entitled to transfer funds to CRR from out of the profits if it resolves to redeem preference shares issued. As the statute itself permits the company to transfer funds to CRR as and when profits accrue, no permission is required at the stage of transfer. But, having regard to the language used in Clause (d) of

proviso to Sub-section (1) of Section 80 of the Companies Act, it is very clear that when once the CRR is used for redemption of preference shares, the company has to necessarily move an application before the Court and obtain permission for utilizing CRR for redemption, because if CRR, which is created out of the profits, is used for redeeming preference shares, it results in diminishing of capital. Therefore, unless and until the resolution of the company to create CRR and use the same for redemption of fully paid preference shares is sanctioned and approved by the Court, no such redemption can be resorted to. When once the amounts available in CRR are utilized for redemption of preference shares, after approval of the Court, the question of further availability of CRR does not arise.

20. The fully paid preference shares issued by a company are always redeemed at the face value or at the issue price only. In a given case, if CRR created by the company exceed or far exceeds the face value of the redeemable fully paid preference shares, how this CRR Account has to be adjusted or used? Section 80(5) of the Companies Act deals with a situation which enables the company to apply CRR in paying up unissued shares of the company to be issued to the members of the company as fully paid bonus shares. Section 80(5A) of the Companies Act contains non obstante clause and indicates that CRR can be applied only for redeeming fully paid-up preference shares and/or for issuing bonus shares to the members. The same cannot be used for any other purpose.

21. The above view is also supported by the Textbook Writers'', C.R. Datta, the learned Author "the Company Law'''' (sixth edition, 2008) elucidated the legal position as under:

Redemption [Sub-section (1), proviso].--Redeemable preference shares can be redeemed only on the following conditions:

(a) Such shares can be redeemed out of distributable profits (profits which would otherwise have been available for dividend) or out of the proceeds of a fresh issue of shares for this purpose.

(b) Such shares must be fully paid-up.

(c) Any premium to be paid on redemption of such shares must have been provided for out of profits or out of the securities premium account.

(d) If the redemption is out of distributable profits, profits equivalent to nominal amount of preference shares redeemed must be transferred to the Capital Redemption Reserve Account. The Capital Redemption Reserve Account will be treated as share capital and the provisions as regards reduction of the share capital shall apply. But, Capital Redemption Reserve Account may be utilised in issuing fully paid Bonus Shares; this will not be treated as reduction of capital [Sub-section (5)].

22. Dealing with interplay between Section 80(1) and Section 100(1) of the Companies Act, the learned Author comments as follows:

Section 100 may be invoked for reduction of any capital including the Preference Shares, subject to approval of the Court with the object that the company may pay back to the shareholders any paid-up share capital which is in excess of its wants. The redemption of preference shares is nothing but repayment of the preference capital and amounts to reduction of share capital. The three methods mentioned in Clauses (a), (b) and (c) of Sub-section (1) of Section 100 of the Companies Act, 1956, are only illustrative and are not exhaustive. A company may seek to redeem the share capital in any way and even in a manner not covered by Clauses (a), (b) and (c) of Sub-section (1) of Section 100. The words ''Pay off any paid-up capital'' appearing in Clause (c) indicate that even the preference share capital can be paid off subject to the conditions laid down in Section 100 of the Act. Section 100 makes no distinction between preference share capital and equity share capital. Thus, the equity share capital as well as the preference share capital of a company can be reduced in any way, if authorised by the Articles, by a Special Resolution of the company subject to sanction of the Court. The preference shares could be redeemed by the directors or the shareholders.

23. K.M. Ghosh and Dr. K.R. Chandratre in their ''Company Law'' (thirteenth edition, 2006-07, p. 1472) also commented in a similar manner, as extracted herein.

According to Sub-section (1)(a), redemption can be done only: (a) out of profits which could otherwise have been available for dividend, or (b) out of the proceeds of a fresh issue of shares made for the purpose of redemption. It should be noted that, balance of profits as appearing in the balance sheet cannot, strictly speaking, be called a source of funds to meet the requirement of funds (cash) for redemption of shares. If a company intends to redeem its preference shares out of profits, it must have not only profits sufficient to be reduced by a sum of the face value and of the premium payable on the redemption but also liquid cash sufficient to meet its obligation of payment to the shareholders whose securities are bought. Thus, free reserves or securities premium are not the sources of funds for buying back securities. A company intending to buy its shares/other securities must have at the time of buy-back, balance in any one or more of these accounts which is sufficient to accommodate the total value of the buy-back.

The sanction of the Court u/s 100 of the Act would be necessary even where preference shares are to be redeemed out of capital redemption reserve account created out of the profits of the company. Again the principle of maintenance of the capital is preserved for the protection of the creditors of the company and sanction of the Court is necessary for reduction of the capital even for redemption of preference shares out of capital redemption reserve account. [Emphasis supplied]

24. The learned author also dealt with the interplay between Sections 80(1) and 100(1) of the Companies Act in the following manner :

Under Clause (c) of Sub-section (1) of Section 100, a company can pay back to the shareholder any paid-up share capital which is in excess of wants of the company. Redemption of the preference shares is nothing but paying back to the shareholders their preference share capital. This can be done subject to confirmation by the Court if the capital is in excess of the wants of the company and the company is so authorized by its articles and the company passes a special resolution to that effect. Therefore, preference shares can be redeemed not only in accordance with Section 80 but, also in accordance with the provisions of Section 100 of the Act. If the shares are to be redeemed not out of the fresh issue of shares made for that purpose nor out of the profits which would otherwise be available for dividend as required u/s 80, provisions of Section 100 of the Act would have to be complied Two independent procedures are available to a company for redemption of preference shares. It may redeem the shares by following the procedure laid down u/s 80 of the Act which is a special provision meant for redemption of preference shares or if any take recourse to the general provision u/s 100 of the Act which is applicable for reduction of any capital including preference capital, in any manner." [Emphasis supplied]

25. In Birla Global Finance Ltd., In re [2005] 126 Comp. Cas. 647 [2004] 50 SCL 387, Bombay High Court dealt with the issue of redemption of preference shares by creation of CRR. It is observed therein as follows:

Money required for redemption of preference shares can be obtained out of two sources u/s 80. The first source is out of the proceeds of a fresh issue of shares made for the purpose of redemption and the second source is out of profits of the company which would otherwise be available for dividend. In the former case, where preference shares are to be redeemed out of the proceeds of a fresh issue of shares made for the purpose of redemption, there is no reduction in the capital of the company for an amount equivalent to or more than the amount to be utilised for the purpose of redemption is raised by the company out of fresh issue of shares. Thus, the capital of the company is maintained and the creditors are not affected. In the latter case, where shares are to be redeemed out of profits of the company which would otherwise be available for dividend, the creditors can be affected because existing money goes out of the company. It is for this reason that proviso (d) to Sub-section (1) of Section 80 of the Act requires the company to create a capital redemption reserve account and transfer thereto a sum equivalent to the nominal amount of the shares to be redeemed. The proviso further provides that the provisions of the Act relating to the reduction of the share capital of the company shall except as provided in the section, apply as if the capital redemption reserve account were the paid-up capital of the company. Thus, the sanction of the Court u/s 100 of the Act would be necessary even where preference shares are to be redeemed out of capital redemption reserve account created out of the profits of the company. Again the principle of maintenance of the capital is preserved for the protection of the creditors of the company and sanction of the Court is necessary for reduction of the capital even for redemption of preference shares out of capital redemption reserve account.... In my opinion, Section 80 of the Act operates in a limited field. It covers only the case of reduction of share capital arising out of redemption of preference shares. Preference shares can be redeemed either out of proceeds of a fresh issue of capital or out of the profits of a company which would otherwise be available for payment of dividend. In the former case, as the capital of the company is maintained, no permission of the Court is necessary. In the latter case provisions as to the reduction of the shares capital are made applicable by virtue of proviso (d) to Sub-section (1) of Section 80.

26. Thus, when a company has issued redeemable preference shares, created CRR in accordance with Section 80(1) proviso (d) and redeemed preference shares, in accounting practice, no amount remains as CRR. In such a case, there cannot be any further prospect of utilising such nonexistent CRR. Even if CRR which might remain in the books of account or in the Balance Sheet, such account shall have to be used for issuing bonus shares as per Section 80(5A) of the Companies Act. Applying these principles, the case of the Petitioner company insofar as first relief is concerned needs to be considered.

Utilisation of Capital Redemption Reserve

27. It is the case of the Aurobindo that during the year 1997-98, 50,000, 12.5 per cent redeemable non-convertible preference shares of Rs. 100 each were issued to Canara Bank for value of Rs. 50,00,000 (Fifty lakhs only) and during 1998-99, 8,50,000, 12 per cent redeemable non-convertible preference shares of Rs. 100 each were issued to Global Trust Bank and SBI Capital Markets Limited for a total value of Rs. 8,50,00,000. Thus, out of authorised preference share capital of 10,00,000 preference shares of Rs. 100 each, 9,00,000 preference shares were issued by 31-3-1999. The first issue during 1997-98 was authorised by resolution of Board of Directors, dated 26-12-1997. The same reads as under:

Minutes of the Meeting of the Board of Directors of Aurobindo Pharma Limited held at 12.30 p.m. on Friday the 26-12-1997 at the Registered Office of the Company at Plot No. 2, Maithrivihar, behind Maithrivanam, Ameerpet, Hyderabad - 500 038.

Allotment of Redeemable Non-Convertible Preference Shares of Rs. 50.00 lakhs in favour of Canara Bank.

The Board was informed that the Company had received Rs. 50.00 lakhs from Canara Bank towards Preference Share Application Money for allotment of 50,000 (Dividend 12.50 per cent p.a. payable annually) Redeemable Non-Convertible Preference Shares of Rs. 100 each per share.

The Board was approved for allotting 50,000 Redeemable Non-Convertible Preference Shares of Rs. 100 each per share to Canara Bank and passed the following resolution:

"RESOLVED THAT 50,000 (Dividend 12.50 per cent p.a.) Redeemable Non-

Convertible Preference Shares of Rs. 100 each per share aggregating to Rs. 50.00 lakhs be and are hereby allotted in the Preference Share Capital of the Company to Canara Bank, Treasury & Investments Division, Treasury & Intl., Operations Wing, HO. 112, J.C. Road, Bangalore-2.

FURTHER RESOLVED THAT the Preference Share Certificate be signed by Sri P.V. Ramaprasad Reddy, Managing Director and Sri A.J. Kamath, Director of the Company and be counter signed by Sri A.N. Sarma, Company Secretary of the Company.

FURTHER RESOLVED THAT the following Directors of the Company Sri P.V. Ramaprasad Reddy and Sri A.J. Kamath, be and are hereby jointly and severally authorized to do take such steps and to do all such acts, deeds, matters and things and accept any alterations or modifications as they may deem fit and proper and give such directions that may arise in regard to the issue and allotment of the said Preference Shares including the power to allot unsubscribed Preference Shares if any in such manner as may appear to the Board of Directors to be most beneficial to the Company and to fix the Common Seal of the company wherever necessary in terms of Articles of Association of the Company.

The issue of 4,50,000 preference shares to SBI Capital Markets was authorized by resolution dated 17-11-1998 of the Board of Directors, which reads as under:

Minutes of the Meeting of the Board of Directors of the Company held at 3.00 p.m. on 17th November, 1998 at the Registered Office of the Company at Plot No. 2, Maithrivihar, behind Maithrivanam, Ameerpet, Hyderabad-500 038.

Allotment of Redeemable Convertible Preference Shares of Rs. 450.00 lakhs in favour of SBI Capital Markets Limited, Mumbai:

The Board was informed that the Company has received a sum of Rs. 450.00 lakhs from SBI Capital Markets Limited as Share Application Money for allotment of 4,50,000 Redeemable Cumulative Preference Shares of Rs. 100 each per share carrying dividend at the rate of 12.00 per cent p.a. payable annually. After discussion, the Board has approved for allotment of 4,50,000 Redeemable Convertible Preference Shares of Rs. 100 each per share to SBI Capital Markets Limited and passed the following resolution:

"RESOLVED THAT 4,50,000 Redeemable Convertible Preference Shares of Rs. 100 each per share carrying dividend at the rate of 12.00 per cent p.a. payable annually, aggregating to Rs. 450.00 lakhs be and are hereby allotted in the Preference Share Capital of the Company to SBI Capital Markets Limited.

FURTHER RESOLVED THAT the Preference Shares Certificate(s) be signed, the Common Seal be affixed by/in the presence of Sri P.V. Ramaprasad Reddy, Managing Director and Sri K.A. Venkatachalam, Director of the Company and be counter signed by Sri A.N. Sarma, Company Secretary on behalf of the Company.

The issue of 4,00,000 preference shares to Global Trust Bank was authorised by resolution, dated 24-11-1998.

Minutes of the Meeting of the Board of Directors of the Company held at 11.00 a.m. on 24th November, 1998 at the Registered Office of the Company at plot No. 2, Maithrivihar, behind Maithrivanam, Ameerpet, Hyderabad-500 038.

Allotment of Redeemable Convertible Preference Shares of Rs. 400.00 lakhs in favour of Global Trust Bank:

The Board was informed that the Company has received a sum of Rs. 400.00 lakhs from Global Trust Bank as Share Application Money for allotment of 4,00,000 Redeemable Cumulative Preference Shares of Rs. 100 each per share carrying dividend at the rate of 12.00 per cent p.a. payable annually. After discussion, the Board has approved for allotment of 4,00,000 Redeemable Convertible Preference Shares of Rs. 100 each per share to Global Trust Bank and passed the following resolution:

"RESOLVED THAT 4,00,000 Redeemable Convertible Preference Shares of Rs. 100 each per share carrying dividend at the rate of 12.00 per cent p.a. payable annually, aggregating to Rs. 400.00 lakhs be and are hereby allotted in the Preference Share Capital of the Company to Global Trust Bank.

FURTHER RESOLVED THAT the Preference Shares Certificate(s) be signed by Sri P.V. Ramaprasad Reddy, Managing Director and Sri A.J. Kamath, Director of the Company and be counter signed by Sri A.N. Sarma, Company Secretary on behalf of the Company."

During 1997-98, Aurobindo transferred Rs. 46,575 from P&L Account to CRR. Thereafter, during the subsequent three years ie., 1998-99, 1999-2000 and 2000-01, Aurobindo transferred more than Rs. 1,00,00,000 each per year to CRR and by 31-3-2001, an amount of Rs. 9,00,00,000 accrued in CRR, which was the amount transferred from P&L Account. The preference shares were redeemed on 17-5-2000, 25-5-2000 and 20-12-2000. Before redemption and after redemption, entries regarding preference share account and CRR in the Balance Sheet and respective schedules for the years 1997-98 to 2007-08 is reflected in the following table:

Extracts from Annual Reports

SI. No. Financial Year Issued, Subscribed and paid-up Redeemable Non-convertible Preference share capital'' Amount transferred from P&L A/c to CRR Amount shown in Schedule annexed to Balance Sheet Value of Redeemed Shares

Rs. Rs. Rs. Rs.

1. 1997-98 50,00,000 46,575 46,575 --

2. 1998-99 8,50,00,000 1,33,88,127 1,34,34,702 --

3. 1999-2000 -- 6,54,75,000 7,89,10,000 --

4. 2000-01 -- 1,10,90,000 9,00,00,000 9,00,00,000

5. 2001-02 -- Nil Nil Nil

6. 2002-03 -- -- 9,00,00,000** --

*Authorised Preference Share Capital is Rs. 10,00,00,000 divided into 10,00,000 shares of Rs. 100 each.

**In subsequent financial years also, an amount of Rs. 9,00,00,000 was shown in Balance Sheet and relevant schedule thereto,

28. This Court has thoroughly perused the Annual Reports for the above years, especially the Balance Sheet and Schedules (a), (b) or (1) (2) thereto which give the details of the authorised and issued share capital, reserves and surplus funds. During the year of issue of 50,000 preference shares, ie., 1997-98 itself, Aurobindo created CRR and transferred funds to CRR. In 1998-99, an amount of Rs. 9,00,00,000 was shown as issued and subscribed preference share capital and an amount of Rs. 7,89,10,000 was shown under CRR and during that year, an amount of Rs. 6,54,75,000 was transferred from P&L Account. During 2000-01, an amount of Rs. 1,10,90,000 was transferred to CRR and as noted supra, the total amount in CRR, which was Rs. 9,00,00,000 was utilised for redeeming 9,00,000 preference shares. This is reflected in Schedule I to Balance Sheet for the year ending 31-3-2001 and issued subscribed paid-up preference share capital was shown as Nil because the amount of Rs. 9,00,00,000 in CRR by the end of financial year 2000-01 was utilised for redeeming preference shares by that year end. During next financial year i.e., 2001-02 in the Balance Sheet, CRR was shown as Niland only issued, subscribed and paid-up equity capital was shown as share capital. This shows that by 31-3-2001, no preference shares were required to be redeemed and nil amount was available in CRR. Therefore, the question of again utilising CRR towards adjusting expenses does not arise.

29. Whether the company acted in compliance with the provisions of the law while redeeming preference shares during 2000-01 ? The answer must be in the negative. As noticed supra, for creation and transfer from out of the profit to CRR, the sanction of the Court is not required. But, as and when CRR is used for redeeming preference shares, the company ought to have obtained the sanction of the Court as if it is reduction of capital under Sections 100 to 103 of the Companies Act. When Aurobindo redeemed preference shares in 2000-01 without obtaining sanction of this Court under Sections 100 to 103, the company committed illegality. It may be noticed that after Court''s confirmation of the Minute for reduction of share capital and publication thereof u/s 102(2B), a certified copy thereof shall be produced before the Registrar of Companies, who shall register the same and on such registration, the Court order shall take effect. This only means that unless and until the order of the Court confirming the Minute is registered by the Registrar of Companies, the preference shares cannot be redeemed from out of the CRR. This procedure was not followed by Aurobindo. As seen from the three resolutions extracted hereinabove, though the

Board of Directors passed resolution for issue of redeemable non-convertible preference shards to Banks, there was no specific authorization to transfer funds to CRR. The language of Section 80(1) provisos (a) and (d) is very clear that if the preference shares are redeemed by issue of shares for the purpose, no permission is required but when the preference shares are to be redeemed otherwise than from the proceeds of the fresh issue of shares, the profits can be transferred to CRR only when the resolution of the Board of Directors. Such a resolution is absent, and therefore, the creation of CRR and transfer of profits itself ultra vires the provisions of the Companies Act.

30. Aurobindo admittedly redeemed preferential shares issued on two occasions in May, 2000 and December, 2000 during 2000-01. This was done without there being compliance with Section 103 of the Companies Act. Such non-compliance with mandatory requirements of law amounts to contravention and attracts Sub-section (6) of Section 80(1) proviso (d) read with Sections 100 to 103 of the Companies Act. The lapses and contravention attract Section 80(d) and are two fold. First, Aurobindo redeemed preference shares from out of CRR as seen from the Balance Sheets for the years 2000-01 and 2001-02, without obtaining the permission of the Court under Sections 100 to 103 of the Companies Act. Secondly, though in the Balance Sheet for 2000-01, the amount of preference shares forming part of share capital was shown as Nil and in Balance Sheet for 2001-02, CRR was shown as Nil, in subsequent years from 2002-03 again the balance available under CRR was shown as Rs. 9,00,00,000. When during 2001-02, CRR was shown as Nil, how Aurobindo has shown Rs. 9,00,00,000 as CRR in subsequent Balance Sheets. It is not their case that after redeeming preference shares issued during 1997-98 and 1998-99, they again issued preference shares and created another CRR. The explanation for this is not forthcoming. Furthermore, when the preference shares were redeemed in 2000-01 from out of the CRR created, Aurobindo chose to file present petition long thereafter on 10-6-2009, and therefore, this Court cannot grant any order approving such reduction as it would amount to approving illegal and ultra vires transaction of Aurobindo.

Reconstruction Reserve Account

31. Aurobindo proposes to undertake financial restructuring by creating "Reconstruction Reserve Account" (RRA). It is proposed to create such RRA (i) by transferring Capital Reserve Account (CRA) of Rs. 9,30,00,000 as on 31-3-2008 to RRA; and (ii) by crediting the amount of benefit arising from buy-back of FCC Bs on or after 1-4-2008 but before 31-12-2009 to RRA, so that the said amount will be available to the Board of Directors for utilization/application for the purposes mentioned in paragraph 1.5 of the Scheme of Arrangement extracted hereinabove. For the sake of convenience, these two aspects need to be dealt with separately.

Foreign Currency Convertible Bonds (FCC Bs)

32. As indicated hereinabove, during the financial year 2005-06, Aurobindo issued FCC Bs for a total sum of US$ 6,00,00,000 for 1,000 each at issue price of 100 per cent. These bonds are convertible at any time on or after 20-9-2005 and up to 1-8-2010 into shares of Rs. 5 each at conversion price of Rs. 522.06 with fixed rate of exchange of conversion of Rs. 43.3925 = US 1$. Similarly, during 2006-07, Aurobindo issued FCC Bs in two tranches. US$ 15,00,00,000 in US$ convertible bonds due 2011 of 100 US$ each in tranch ''A'' and US$ 50 million (5,00,00,000) forward convertible bonds due 2011.FCC Bs in tranch ''B'' are convertible at any time on or after 27-6-2006 and up to 10-5-2011 into shares of the company at a conversion price to be determined on 17-5-2007 with fixed rate of exchange of conversion of Rs. 45.145 = US 1$.

33. RBI issued Circular bearing No. AP (DIR Series) Circular No. 39, dated 8-12-2008 permitting Authorised Dealer (AD) Category-I Banks to allow Indian Companies to prematurely buy-back FCC Bs, if the buy-back value of the FCC Bs is minimum discount of 15 per cent of the book value. The funds used for the buy-back shall be out of existing foreign currency funds held by the company either in India or out of fresh External Commercial Borrowings (EC Bs) in conformity with ECB norms. This is under automatic route and does not require approval of Reserve Bank of India. The buy-back of FCC Bs under approval route was also permitted. In this category, buy-back value of FCCB shall be at a minimum discount of 25 per cent on the book value and the funds used for buy-back shall be out of external accruals to be certified by statutory auditors and authorised Dealer-I Banks certificate. Under this, the total amount of buy-back shall not exceed US$ 50 million of the redemption value for the company. The buy-back authorised by RBI in Circular No. 39 is subject to the following conditions:

General conditions

In addition to the conditions set out above, the following additional conditions shall be applicable for the proposals both under the automatic and approval routes:

(i) the FCCB should have been issued in compliance with the extant guidelines.

(ii) The FCCB should have been registered with the Reserve Bank, the LRN number obtained and ECB 2 returns submitted up to date.

(iii) No proceedings for contravention of FEMA are pending against the company.

(iv) The right for buy-back is vested with the issuer of FCC Bs. However, the actual buy-back is subject to the consent of the bond holders.

(v) The FCC Bs bought back/repurchased from the holders must be cancelled and should not be reissued or re-sold.

(vi) The buy-back will not have any effect on the bond holders not opting for the buy-back or on the non-participating bond holders of companies opting for the buy-back.

(vii) The Indian company shall open an escrow account with the branch or subsidiary of an Indian Bank Overseas or an International Bank for buying back the FCC Bs to ensure that the funds are used only for the buy-back.

34. Under Circular No. 39, the last date was fixed as 31-3-2009. However, by issuing A.P. (DIR Series) Circular No. 58, dated 13-3-2009, RBI extended the date for completing the entire procedure for buy-back of FCC Bs up to 31-12-2009 without changing terms and conditions in Circular No. 39. The mandatory conditions stipulated in Circular No. 39 require any company buying back FCC Bs to open an escrow account with an Indian Bank or Overseas Bank or international bank for buying back the FCC Bs. This means the amounts in escrow account can alone be used for buying back FCC Bs. Further, the proceedings shall not be contravention of FEMA.

35. As per Foreign Exchange Management (Transfer of Issue of any Foreign Security) (Amendment) Regulations, 2004 (hereafter called, FEMA Regulations), FCCB means a bond issued by an Indian company expressed in foreign currency and the principle and interest is payable only in foreign currency. But for the Regulations, the issue of foreign security is prohibited except with the permission of RBI. Regulation 4 permits any person resident in India either to purchase or to sell foreign security. Part I of the Regulations deals with direct investment outside India whereas Parts II and III deal with investments abroad by individuals and investments in foreign securities other than by direct investment. Regulation 21(2)(i) of the Regulations enables Indian company to issue FCC Bs not exceeding US$ 500 million and/or to issue FCC Bs beyond US$ 500 million with the approval of the Bank. That is to say, if the total value of FCC Bs does not exceed US$ 500 million, it is automatic route not requiring prior permission of RBI but subject to the conditions stipulated in Schedule I to the Regulations. If a company issues FCC Bs either through automatic route or regulated route, within thirty (30) days after such issue, a company has to furnish a report to RBI giving the details and documents with regard to the total amount for which FCC Bs are issued, names of the investors and number of FCC Bs and the amount repatriated to India through normal banking channels and/or the amounts received by debit through NRE/ FCNR account of investors.

36. Schedule I referred to in Regulation 21(2)(i) of FEMA Regulations provides conditionalities for automatic route for issue of FCC Bs. Conditions (vz) and (viii) are important. These stipulate that all in cost will be on part that those prescribed for External Commercial Borrowing (ECB) and the proceeds from FCC Bs shall be used for the purpose for which ECB proceeds are permitted to be utilized under ECB schemes. The regulations are silent as to how the benefit that may accrue due to buy-back of FCC Bs at discounted price can be utilized by the company. If the FCC Bs are liabilities of the company shown in the Balance Sheet, the premium on conversion of FCC Bs and the amounts realized by issue of such FCC Bs shall have to be shown in the Balance Sheet. What would happen

when FCC Bs are bought back from out of the Foreign Currency Reserves parked in escrow account with a bank as mentioned in general condition

(vii) of Circular No. 39 referred to hereinabove? Whether Aurobindo has complied with all these conditions?

37. The petition does not disclose whether the payment under the buy-back has been completed, and whether resources have been created by opening escrow account for such purpose. The Board of Directors of Aurobindo passed resolution on 30-7-2008 for purchase of FCC Bs from open market at a price not exceeding face value of the bonds and for consequential cancellation up to and aggregate of US$ 100 million out of the outstanding three FCCB series. Except these particulars, no details are forthcoming regarding source of funds to buy-back. There is no mention of Foreign Currency internal accruals. The Balance Sheet for 2007-08 (provisional) and the provisional Balance Sheet for 2008-09 are also not clear as to the buy-back of funds. The company petition was filed on 10-6-2009 and by that date the buy-back is not completed. Therefore, unless and until the actual benefit that accrues to the company from out of the buy-back at discounted price, and is shown in Balance Sheet, it cannot be assumed that benefit would accrue to the company. Secondly, Board of Directors passed resolution on 30-7-2008 to buy-back and cancel the FCC Bs, in which event, the alleged accruals would be nil It is well settled that when a Scheme of Arrangement is submitted for approval, a company is required to place all the details to enable the Court to consider its vires before granting approval. It is not clear as to how much benefit would accrue to Aurobindo. It is also not clear whether such accruals can be permitted to be utilized for creation of RRA authorizing the Board of Directors to use the funds for the purpose enumerated in Clause 1.5 of the Scheme of Arrangement. In the absence of all the details, this Court is not inclined to approve the Scheme of Arrangement with regard to creation of RRA by transferring the benefits to be accrued from buy-back of FCC Bs.

Capital Reserve Account

38. The Scheme was approved by Board of Directors of Aurobindo on 31-3-2009 and the Managing Director and/or CFO and/or Company Secretary are authorized to take all necessary steps in compliance with the Companies Act and Company Rules. The Board of Directors also resolved for constitution of restructuring committee to give effect to the Scheme. It is not clear from the resolution whether the Board considered pointedly the transfer of capital reserve as on 31-3-2008 to RRA for the year ended 31-3-2009 for being utilized towards adjusting expenses as mentioned in Clause 1.5. Assuming that the Board of Directors had applied its mind to this aspect of the matter, the question would be whether CRA can be permitted to be utilized for creation of RRA to write off towards intangible assets, towards unrealizable loans, interest/financial charges, outstanding receivables, to write off/amortization of goodwill etc.

39. There cannot be any dispute, the capital reserve can be utilized by the company for the purposes authorized in law and in such a case, no permission of the Court is required. It is a matter of good corporate practices and business prudence whether or not capital reserve be utilized for meeting a particular contingency. But when the CRA is directly or indirectly used in a manner that it results in reduction of share capital, the permission of the Court is required. The purposes for which RRA is sought to be used are certainly not the purpose for which CRA can be utilized as noticed infra.

40. The terms ''reserve'', ''capital reserve'' and ''reconstruction reserve'' are not defined in the Companies Act. Section 211 of the Companies Act requires every company to prepare the Balance Sheet containing the true and fair view of the state of affairs of the company at the end of the financial year in the form set out in Part I of Schedule VI or as near thereto as circumstances admit. Schedule VI contains horizontal form as well as vertical form of Balance Sheet in Part I. Part II contains provisions to be applied to income and expenditure account referred to in Section 210(2) of the Companies Act. Part III contains Rules 7 and 8. For our purpose, Rule 7(1) is relevant as this explains the expressions ''reserve'' and ''capital reserve'':

7. (1) For the purposes of Parts I and II of this Schedule, unless the context otherwise requires,--

(a) the expression "provision" shall, subject to Sub-clause (2) of this clause, mean any amount written off or retained by way of providing for depreciation renewals or diminution in value of assets, or retained by way of providing for any known liability of which the amount cannot be determined with substantial accuracy;

(b) the expression "reserve" shall not, subject as aforesaid, include any amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets or retained by way of providing for any known liability;

(c) the expression "capital reserve" shall not include any amount regarded as free for distribution through the profit and loss account; and the expression "revenue reserve" shall mean any reserve other than a capital reserve;

and this sub-clause the expression "liability" shall include all liabilities in respect of expenditure contracted for and all disputed or contingent liabilities.

The Compendium of Guidance Notes (Accounting) published by Institute of Chartered Accountants of India (ICAI) (July 2006 edn.,) defines ''reserve'' as under:

Reserve: The portion of earnings, receipts or other surplus of an enterprise (whether capital or revenue) appropriated by the management for a general or a specific purpose other than a provision for depreciation or diminution in the value of assets or for a known liability. The reserves are primarily of two types: capital reserves and revenue reserves. [Emphasis supplied]

41. The term ''capital reserve'' is defined in ICAI Guidance Notes as a reserve of a corporate enterprises which is not available for distribution as dividend. This means when once capital reserve is created, the same cannot be utilized for any other purpose except for the purpose for which it is intended. Capital reserve cannot be used even for distribution for dividend. The revenue reserve unlike capital reserve is considered as free reserve available for issue of bonus shares. Further, capital reserves are derived from non-trading operations of the company and reserve so created out of the realization is termed as capital reserve. As already seen, as per Schedule VI, Part III of the Companies Act, the reserve shall not include any amount written off or retained by way of providing depreciation, renewals or diminution in value of assets or retained by way of providing for any unknown liability, which cannot be determined with substantial accuracy. From this, it becomes clear that capital reserve cannot be used for writing off loss or for adjusting towards diminution of value of assets etc.

42. In Commissioner of Income Tax, Bombay City Vs. The Century Spinning and Manufacturing Co. Ltd., , Constitution Bench of the Supreme Court considered the term ''reserve''. It was held that the term reserve ''should be given the ordinary natural meaning as understood in the common parlance and that profits lying unutilized and not specifically set apart for any purpose would not constitute reserves.'' It was also held that the reserve may be a general reserve or a specific reserve but there must be clear indication to show that whether it is a reserve either of the one or other kind. When once capital reserve is created, the company had no power to distribute the same as dividend, but the same should be set apart for investment in the company and not to write off the losses of a company or its subsidiaries. ''Capital reserve'' therefore cannot be used for writing off losses and as noticed supra, a capital reserve is not a free reserve and cannot be used for purposes not authorized under law.

43. In Commissioner of Income Tax, Madras Vs. P. Veeraswami Nainar Bus owner and the mill owner Ginjee and Others, , the Assessee was an HUF with bus/lorry transport business, filed Return for 1959-60 showing loss of Rs. 20,441 after deducting development rebate of Rs. 18,965 at 25 per cent on a new lorry and a new bus purchased subsequent to December, 1957. But, the Assessee did not debit 75 per cent of that amount to the profit and loss account and consequently rebate claimed had not been credited to the reserve account as required u/s 10(2)(vib) of the Income Tax Act, 1922. Income Tax Authorities refused to allow development rebate on the ground that bus and lorry cannot be regarded as plant and machinery within the meaning of said provision. The appellate authority agreed with Income Tax Officer, but on further appeal, the Income Tax Appellate Tribunal referred the question to the High Court as to whether the Assessee can claim allowance even though necessary reserve was not created as required under law. Madras High Court answered reference against the Assessee and it was held:

It will be apparent from the terms of the proviso that the object of the Legislature in allowing a development rebate is a real one, that is, to facilitate the improvement of the Assessee''s business from out of the reserve fund. The entries in the account books required by the proviso are not an idle formality. The Assessee being obliged to credit the reserve fund for a specific purpose, he cannot draw upon the same for purposes other than those of the business, and if the Assessee were a company for exemption that amount could not be distributed by way of dividend. It is also clear from the terms of the proviso that the reserve should be made at the time of making up the profit and loss account. The Tribunal was clearly in error when it held that account by making the reserve at a later period of time. Any account maintained by a business should reflect its financial transactions correctly. If at the time of the closing of the accounts for a year, a particular appropriation had not been made, but the moneys had been spent otherwise, it would indeed be futile to direct the Assessee to re-adjust the account.

(Emphasis supplied)

44. The dicta in Veeraswami Nainar''s case (supra) was approved by Supreme Court in The Indian Overseas Bank Ltd. Vs. The Commissioner of Income Tax, Madras, , wherein it was held:

The reserve contemplated by that provision is a separate reserve. The amount transferred to that reserve cannot be utilized for business purposes. The reserve contemplated by proviso (b) to Section 10(2)(vib) of the Act is an independent reserve. The amount to be transferred to that reserve is debited before the profit and loss account is made up. That amount is required to be credited to a reserve account to be utilized by the Assessee during a period of ten years for the purposes of the business of the undertaking. The nature of the two reserves are different. They are intended to serve two different purposes. As observed by the Madras High Court in Veeraswami Nainar (supra) that the object of the Legislature in allowing a development of the Assessee''s business from out of the reserve fund is apparent from the terms of the proviso. The entries in the account books required by the proviso are not an idle formality. The Assessee being obliged to credit the reserve fund for a specific purpose, he cannot draw upon the same for purposes other than those of the business and that amount cannot be distributed by way of dividend. It is also clear from the terms of the proviso that the transfer to the reserve fund should be made at the time of making up the profit and loss account.

(Emphasis supplied)

Whether Members of Aurobindo approved the Scheme u/s 391(1) and (2) of Companies Act?

45. This Court appointed Chairperson to convene the meeting of equity shareholders to consider and approve the resolution to support the Scheme of Arrangement proposed by the Board of Directors of Aurobindo. The chairperson

convened the meeting of the shareholders at 3.00 p.m. on 21-5-2009 at Katriya Hotel and Towers, Hyderabad. In all 177 shareholders (either in person or through proxies/representations) of Aurobindo representing 3,49,88,412 equity shares of Rs. 5 each aggregating to Rs. 17,49,42,060 attended the meeting. Out of them, 93.92 per cent of shareholders voted and approved the following resolutions:

Resolution 1.--Resolved that the Scheme of Arrangement by and between Aurobindo Pharma Limited and its shareholders tabled before the meeting and initiated by the Chairman for identification purpose be and is hereby approved.

Special Resolution 2.--Resolved that the Applicant company be and is hereby authorized to exercise all the powers conferred under Sections 100 to 103 of the Companies Act, 1956, to adjust the amount standing to the credit of Capital Redemption Reserve Account as on March 31, 2008 against the expenses as provided for in the Scheme of Arrangement between Aurobindo Pharma Limited and its Shareholders on March 31, 2009.

Special Resolution 3.--Resolved that the Board of Directors of the Applicant Company (hereinafter referred to as ''the Board'' which expression shall also include any Restructuring Committee constituted thereof) be and is hereby authorized to do all such acts, deeds, matters and things, which the Board considers necessary, requisite, desirable or appropriate and to make, agree or accept such modifications/amendments/limitations and/or conditions arising out of or by virtue of the said Scheme or as may be directed or imposed by the Stock Exchange with whom the shares of the Company are listed and/or any other authorities and/or by the Hon''ble High Court of Judicature of Andhra Pradesh at Hyderabad and which the Board considers necessary to effectively implement the said Scheme.

46. Resolution 1 and Resolution 3 above are in general terms. Resolution 2 passed by majority shareholders presented in the meeting authorized Aurobindo to adjust the amount standing to the credit of Capital Redemption Reserve as on 31-3-2008 against planned expenses. There is no such special resolution passed by equity shareholders in the meeting convened by chairperson appointed by this Court in relation to creation of Reconstruction Reserve Account and transfer to it, capital reserve and/or the benefit accruing from buy-back of FCC Bs. When there is no specific resolution by equity shareholders, compliance with Section 391 of the Companies Act, cannot be inferred. If the intention was to obtain general approval for the Scheme of Arrangement, there was no necessity for moving special resolution. When the equity shareholders approved special resolution with regard to adjusting CRR, nothing prevented passing a similar special resolution with regard to transfer of capital reserve and/or FCCB benefit to RRA. When the Scheme of Arrangement is proposed by Board of Directors with regard to three aspects and a special resolution is passed only with reference to one subject concurrence of majority shareholders cannot be inferred with reference to other aspects. This is also one of the reasons which would disqualify the petition for

approval.

47. This Court has carefully perused the annual reports and Balance Sheets of Aurobindo for the years 2000-01 to 2007-08. In none of these, there is no indication for utilizing capital reserve for the purposes intended now by transferring to RRA. As capital is not a free reserve, it cannot be allowed for payment of any future liability or for depreciation of assets or for bad debts. As noticed supra, Aurobindo proposes to transfer capital reserve account to RRA to write-off capital lost and other losses. This is not permissible under law. Therefore, this Court is not inclined to approve the Scheme of Arrangement as proposed.

48. The company petition is therefore dismissed.

Petition dismissed.