

(2003) 11 BOM CK 0045

In the Bombay High Court

Case No : Company Petition No. 228 of 2002 and Company Application No. 149 of 2002

In Re: Birla Global Finance Ltd.

Date of Decision : 18-11-2003

Acts Referred:

Companies (Amendment) Act, 1988 — Section 80A
Companies Act, 1956 — Section 100, 101(1), 80, 80(1), 86

Citation : (2005) 126 CompCas 647 : (2004) 1 CompLJ 430 : (2004) 50 SCL 387

Hon'ble Judges : D.G. Karnik, J

Bench : Single Bench

Advocate : S.A. Diwan, S. Purohit and Mona Bhide, for the Appellant;

Final Decision : Allowed

Judgement

D.G. Karnik, J.—A short question of law that arises for consideration in this petition is :

(1) Whether the preference shares can be redeemed otherwise than out of the profits of the company which would otherwise be available for dividends or out of the proceeds of the fresh issue of shares made for the purpose of redemption ?

The relevant facts are stated below :

2. The petitioner was incorporated on 26th June, 1986 under the provisions of the Companies Act, 1956 (for short, "the Act") and the authorised share capital of the petitioner is rupees one hundred and twenty-five crores divided into five crore equity shares of Rs. 10 each and seventy-five lakhs preference shares of Rs. 100 each. As on the date of filing of the petition (i.e. on 10th February, 2003) the subscribed and paid up share capital of the petitioner was Rs. 43,25,04,390 consisting of Rs. 1,57,50,439 equity shares of Rs. 10 each fully paid up and Rs. 27,50,000 fully paid up preference shares of Rs. 100 each.

3. The Balance sheet of the petitioner company as of 31st March, 2002 (annexed as Exhibit C-1 to the petition) shows that the petitioner has issued four types of preference shares as detailed below :

Type Nos. Total value (Rupees)

(1) 10.5% redeemable cumulative preference shares of Rs. 100 (Series N Preference shares) 2,50,000 2,50,00,000

(2) 10.75% redeemable cumulative preference shares of Rs. 100 (Series M Preference shares) 2,50,000 2,50,00,000

(3) 11.50% redeemable cumulative preference shares of Rs. 100 1,38,000 1,38,00,000

(4) 12.5% redeemable cumulative preference shares of Rs. 100 30,000 30,00,000

4. During the period between 1st April, 2002 and 30th September, 2002 the petitioner has redeemed 1,10,000 numbers of 11.5 per cent redeemable cumulative preference shares (i.e. part of shares mentioned at Sr. No. 3 above) and 30,000 numbers of 12 per cent redeemable cumulative preference shares (i.e. all of the shares mentioned at Sr. No. 4 above). As per the affidavit dated 8th July, 2003 sworn in by Mr. Arun Bhatt, Manager (Secretarial) of the petitioner company, the redemption mentioned above was made out of fresh issue of redeemable cumulative preference shares namely 25,00,000 number of 10.75 per cent redeemable cumulative preference shares issued on 11th August, 1999 (mentioned at Sr. No. 2 above). Copy of the resolution passed at the meeting of the Board of Directors of the petitioner company held on 10th September, 1999 shows that the proceeds of the issue of 2,50,000 numbers of 10.75 per cent redeemable cumulative preference shares of (series M) were to be utilised for the purpose of part or full redemption of the preference shares issued earlier by the company. Learned counsel for the petitioner submits that no time limit is prescribed u/s 80 of the Act within which the proceeds of fresh issue of preference shares can be utilised for redemption of preference shares issued in the past. As such, the proceeds of the preference share issued on 11th August, 1999 have been utilised between 1st March, 2002 and 30th September, 2002 for the purpose of redemption of 11.5 per cent and 10.5 per cent redeemable preference shares in the manner mentioned earlier. Learned counsel further submits that the said shares were redeemed in the manner laid down u/s 80 of the Act and hence no permission of the Court was obtained for the said redemption. The said shares have been redeemed prior to the filing of the petition and are not the subject-matter of this petition.

5. The entire lot of 25,00,000 numbers of 10.75 per cent redeemable preference shares (hereinafter referred to as "series M preference shares") were allotted to Hindalco Industries Ltd. on 11th August, 1999 and are continued to be held by it. All the shares are comprised in one share certificate bearing share certificate No. P/M/1 and stand in the name of Hindalco Industries Ltd. under Folio No. PREF/M/1. A copy of the share certificate is annexed as Exhibit F2 to the petition. The terms and conditions of the issue of the preference shares printed on the reverse side of the preference share certificate show that maturity period of the

preference shares is 10 years from the date of allotment. On or after 30th September, 2002 the petitioner company as well as the preference share holder have an option of early redemption which can be exercised by giving one month's notice to the other party.

6. 2,50,000 numbers of 10.5 per cent redeemable preference shares of series N (hereinafter referred to series N preference shares) were issued and allotted to Excell Mines and Industries on 16th September, 1999. All the shares are comprised in one share certificate bearing No. P/N/1 and stand in the name of Excell Mines and Industries Limited under Folio No. PREF/N/1. Copy of the said share certificate is annexed as F3 to the petition. The terms and conditions of the issue of the preference shares printed on the reverse side of the share certificate show that they have maturity period of 10 years from the date of allotment. On or after 30th September, 2002 the petitioner company as well as the or the shareholders have an option of early redemption to be exercised by giving one month's notice to other party.

7. From the terms of issue of series M and N preference shares, it is clear that the said shares are redeemable after 30th September, 2002 at the option of the petitioner or the shareholders by giving one month's notice, By a resolution passed in the meeting of the Board of Directors of the petitioner company held on 31st October, 2002 the petitioner company resolved to redeem all the 27,50,000 redeemable cumulative preference shares of series M and N as referred to above subject to the special resolution to be passed by the shareholders in the extraordinary general meeting to be convened for that purpose and subject to confirmation by the High Court at Bombay. Accordingly, an extraordinary general meeting of the members of the petitioner company was convened on 29th January, 2003 to consider the redemption of series M and N preference shares. Both of preference shareholders namely Hindalco Industries Limited and Excell Mines and Industries Limited, who belong to Aditya Birla Group to which the petitioner company also belongs, have also consented for the redemption of the said preference shares. The said two companies have by their letters dated on 28th January, 2003 and 30th January, 2003 respectively conveyed their consent for the redemption and consequent reduction in the capital Copies of the said letters are annexed at Exhibits F1 and F to the petition.

8. Armed with the special resolution for reduction of the share capital and having obtained consent of the preference shareholders, the petitioner company filed the Company Application No. 139 of 2003 for dispensation of the procedure u/s 101(1) of the Companies Act. By an order dated 29th April, 2003 this court dispensed with the procedure under Sub-section (1) of Section 101 of the Act. Thereafter, the present petition has been filed seeking approval and sanction of the court for redemption of series M and N preference shares and consequent reduction of the share capital by Rs. 27,50,00,000.

9. Section 80 of the Act permits a company limited by shares, if so authorised by its Articles, to issue preference shares which at the option of the company are

liable to be redeemed. After addition of Section 80A in the Act, the company cannot issue irredeemable preference shares and all the preference shares issued prior to the amendment of the Act, by Companies (Amendment) Act, 1988 have also to be redeemed within a period specified. Section 80 of the Companies Act, 1956 which lays down conditions of redemption, reads as under :

"80. Power to issue redeemable preference shares.--(1) Subject to the provisions of this section, a company limited by shares may, if so authorised 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.

(2) Subject to the provisions of this section, the redemption of preference shares thereunder may be effected on such terms and in such manner as may be provided by the articles 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 authorised share capital.

(4) Where in pursuance of this section, a company has redeemed or is about to redeem any preference shares, it shall have power to issue shares up to the nominal amount of the shares redeemed or to be redeemed as if those shares had never been issued; and accordingly the share capital of the company shall not, for the purpose of calculating the fees payable u/s 611 be deemed to be increased by the issue of shares in pursuance of this sub-section :

Provided that, where new shares are issued before the redemption of the old shares, then new shares shall not so far as relates to stamp duty, be deemed to have been issued in pursuance of this sub-section unless the old shares are redeemed within one month after the issue of the new shares.

(5) The capital 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.

(5A) Notwithstanding anything contained in this Act, no company limited by shares shall, after the commencement of the Companies (Amendment) Act, 1996, issue any preference share which is irredeemable or is redeemable after the expiry of a period of twenty years from the date of its issue.

(6) If a company fails to comply with the provisions of this section, the company, and every officer of the company who is in default shall be punishable with fine which may extend to ten thousand rupees."

Proviso (a) to Sub-section (1) of Section 80 makes it clear that preference shares can be redeemed only-

(i) out of profits of the company which would otherwise be available for dividend; or

(ii) out of the proceeds of a fresh issue of shares made for the purpose of redemption.

9A. In the present case, the petitioner is not seeking to redeem the shares either out of the accumulated profits which would otherwise be available for dividend nor out of the fresh issue of shares. In the circumstances, the petitioner company is not entitled to redeem the shares by following the procedure under proviso (a) to Section 80 of the Act. Is there any other mode or manner in which the preference shares can be redeemed? Mr. Diwan submitted that redemption of preference shares amounts to a reduction of capital and can also be undertaken following general provisions for reduction of capital of any type equity or preference by following the provisions of Section 100 of the Companies Act. According to Mr. Diwan, Section 80 is a special provision which does not exclude general provisions relating to reduction contained in Sections 100 to 104 of the Act.

10. Section 100 of the Companies Act reads as under :

"100. Special resolution for reduction of share capital--(1) Subject to confirmation by the Court, a company limited by shares or a company limited by guarantee and having a share capital, may, if so authorised by its articles, by special resolution, reduce its share capital in any way; and in particular and without prejudice to the generality of the foregoing power, may-

(a) extinguish or reduce the liability on any of its shares in respect of share capital not paid-up;

(b) either with or without extinguishing or reducing liability on any of its shares, cancel any paid up share capital which is lost, or in unrepresented by available assets; or

(c) either with or without extinguishing or reducing liability on any of its shares, pay off any paid up share capital which is in excess of the wants of the company; and may, if and so far as is necessary, alter its memorandum by reducing the amount of its share capital and of its shares accordingly.

(2) A special resolution under this section is in this Act referred to as "resolution for reducing share capital".

11. A company having a share capital, if so authorised by its articles, by a special resolution and subject to confirmation by the court is entitled to redeem the share capital in any way. The three methods mentioned in Clauses (a), (b) and (c) of Sub-section (1) of Section 100 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. Clauses (a), (b) and (c) of Sub-section (1) of Section 100 are only illustrative of the modes of reduction. The redemption of preference shares is nothing but, repayment of the preference capital and amounts reduction of share capital. The words "pay off any paid up capital" appearing in Clause (c) of Sub-section (1) of Section 100 indicate that even the preference share capital can be paid off subject to the conditions laid down in Section 100 of the Act.

12. A company though a legal person in the eye of law is an abstract entity. In case of a company limited by shares, the liability of the members is limited to the extent of the share capital subscribed by them. The members are not personally liable for the dues of the company. Any person dealing with the company, therefore, only has to look to the capital of the company for repayment of his dues. A stranger dealing with the company and giving it credit does so, atleast in theory, on the assumption that the capital of the company as represented by its assets including cash, would be available to them for recovery of all his dues though in practice he may look beyond the capital to the other things such as commercial solvency, liquidity and reputation of the company. Since the liability of the members is limited to the extent of the capital, a creditor cannot look beyond the capital of the company. Hence, law requires that the capital of the company should be preserved and maintained. The Act therefore, imposes severe restrictions on reduction of the capital. The capital is not allowed to be reduced without permission and sanction of the court u/s 100 of the Act. Section 100 applies to reduction of types of capital. u/s 86 of the Act, the share capital of the company can consist of only two types namely equity and preference share capital. By the Companies (Amendment) Act, 2000 equity capital is permitted to be of two types. Section 100 applies for reduction of any type of the capital of the company. Section 100 makes no distinction between the preference share capital and the 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 share capital of a company is generally redeemable and after introduction of Section 80A by the Companies (Amendment) Act, 1988 even

irredeemable shares issued prior to the amendment are made redeemable and have to be redeemed by the company within the time prescribed therein. A stranger dealing with the company therefore knows and understands that the preference share capital would be redeemed in accordance with the terms of its issue and would be available for repayments of his dues or credit. It is for this reason that permission of the court is not made necessary when preference shares are to be redeemed in accordance with Section 80 of the Act. 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 principal 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.

13. 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.

14. 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 exercise 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 authorised by its Articles and the company passes a special resolution to that effect. In my opinion, 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 it may 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.

15. I would now consider whether court should sanction the present redemption which is by way of redemption of preference share capital should be sanctioned in its discretion u/s 100 of the Act.

Article No. 65 and amended Article No. 4 of the Articles of Association of the petitioner authorise the company to reduce the share capital. The petitioner has passed a special resolution in the general meeting held on 29th January, 2003 for redemption of the preference shares by refunding to the preference shareholders the amount paid up thereon subject to confirmation of the High Court. The terms of the issue of the preference shares show that the preference shares are redeemable at the option of the directors of the petitioner company or the preference shareholders. Both the preference shareholders have recorded their consent for redemption of preference shares. In the circumstances, I do not see any reason not to grant sanction to the proposed reduction. The petition is accordingly allowed in terms of prayers Clauses (a) and (b).