

(2009) 03 BOM CK 0046

In the Bombay High Court

Case No : Company Petition No's. 382 and 383 of 2008 and Company Application No's. 253 and 254 of 2008

In Re: Niulab Equipment Co. (P.) Ltd.

Date of Decision : 24-03-2009

Acts Referred:

Companies Act, 1913 — Section 85, 86
Companies Act, 1956 — Section 173, 235, 236, 237, 238

Citation : (2009) 152 CompCas 375 : (2009) 3 CompLJ 87 : (2009) 91 SCL 387

Hon'ble Judges : S.J. Vazifdar, J

Bench : Single Bench

Advocate : Shyam Mehta and Rajesh Shah, for the Appellant; C.J. Joy, Bharati Mahant and S.K. Mohapatra, for the Respondent

Judgement

S.J. Vazifdar, J.—The petitioners seek the sanction of this Court to a scheme of amalgamation. The petitioner in Company Petition No. 382 of 2008, Niulab Equipment Company Pvt. Ltd., is the transferor-company and the petitioner in Company Petition No. 383 of 2008, Ashok Industries Ltd., is the transferee-company.

2. The provisions of the scheme as such have not been challenged or even questioned. It is not necessary, therefore, to deal with it in any detail. Suffice it to state, that under the scheme, the entire undertaking of the transferor-company is to stand transferred to and vested in the transferee-company as a going concern, subject to the same being sanctioned by this Court. Under the scheme, two equity shares of Rs. 10 each credited as fully paid up capital of the transferee-company are to be issued and allotted to all the equity shareholders of the transferor-company for every one equity share of the face value of Re. 1 each, held by them of the transferor-company.

3. The petitioners are under the same management. This was so stated in the Company Application as well as in the Company Petition.

4. Company Application No. 253 of 2008 was taken out by the transferor-company and Company Application No. 254 of 2008 was filed by the transferee-

company. The Company Applications were disposed of by orders dated 22-2-2008.

5.(A) In Company Application No. 253 of 2008 the learned Judge dispensed with the convening and holding of the meeting of the equity shareholders of the transferor-company in view of the consent given by all equity shareholders agreeing to the scheme of amalgamation. By the said order, the convening and holding of the meeting of the only secured creditor of the transferor-company was also dispensed with in view of the averment in paragraph 15 of the Company Application, that there was only one secured creditor viz. Punjab National Bank of the value of Rs. 4,43,92,831 who would not in any way be affected by the scheme as the assets of the transferor-company after the proposed amalgamation would be far more than its liabilities and, as such, sufficient to discharge the liabilities and the undertaking to give notice of the date of hearing of the petition by RPAD to the Punjab National Bank. The transferor-company was, however, directed to convene a meeting of the unsecured creditors for the purpose of considering and, if thought fit, approving, with or without modification, the scheme of amalgamation.

The order directed one Ashok Kotwani, director of the transferor-company and, failing him, Mrs. Kanchan A. Kotwani, also a director of the company, to be the Chairman of the said meeting, who, in turn, was directed to report the result thereof within 30 days of the meeting.

(B) There is no dispute that the procedure as well as the above order were duly complied with. The unsecured creditors unanimously approved the scheme.

(C) By an order dated 25-4-2008 the above petition was admitted, fixed for hearing on 27-6-2008 and the usual directions regarding the public notices and notice to the Regional Director, the Official Liquidator and the secured creditor were given. The petition now comes up for final hearing.

6.(A) In Company Application No. 254 of 2008, the order dated 22-2-2008 directed the transferee-company to convene a meeting of the equity shareholders and the unsecured creditors for the purpose of considering and, if thought fit, approving with or without modification, the scheme of amalgamation. The order appointed the said Ashok Kotwani and failing him, the said Mrs. Kanchan A. Kotwani, to be the Chairman of the meeting.

The meeting of the secured creditors, however, was dispensed with in view of what was stated in paragraph 15 of the Company Application viz. that there were four secured creditors of the value of Rs. 15,36,47,678 who would not be affected by the proposed scheme of amalgamation, and the undertaking of the transferee-company to give individual notices of the date of hearing of the petition through RPAD to all the secured creditors.

(B) There is no dispute that the procedure as well as the above orders were duly complied with. The equity shareholders and the unsecured creditors approved

the scheme.

(C) By an order dated 25-4-2008 in the above petition, directions were passed in similar terms as those in respect of the transferor-company. This petition, therefore, comes up for final hearing.

7. The Official Liquidator has filed an affidavit in Company Petition No. 382 of 2008 stating that the affairs of the transferor-company had been conducted in a proper manner and that the transferor-company may be ordered to be dissolved by this Court. The Official Liquidator has not opposed the scheme being sanctioned.

8. As noted above, the entire procedure has been followed. Notices have been given to all the concerned parties. There has been no objection raised by any shareholder or creditor or any other person to the scheme being sanctioned.

9. The Regional Director, however, has filed a common affidavit in the above Company Petitions stating that subject to what is stated in paragraphs (viii) and (ix), the scheme appears to be in order. Paragraphs (viii) and (ix) of the affidavit read as under:

(viii) That affidavits vide dated 16-12-2008, Mr. Ashok Kotwani, Managing Director of the Transferee-Company admitted that the company and its directors, having regard to the legal opinion and certificates of Company Secretaries, have violated provisions of Section 297 of the Companies Act, 1956 during the last 3 years. Copy of the said affidavits enclosed herewith and marked as Exhibits "E-1" & "E-2". The Transferee Company had also moved an application for compounding of the said offence.

(ix) Deponent further submits that, a further affidavit dated 16-12-2008 was filed by the said Mr. Ashok Kotwani, Managing Director of the Transferee Company, also admitting violation of Section 295 of the Companies Act, 1956 in respect of the issue of a Corporate Guarantee of Rs. 765 lakhs by the company, on behalf of the Transferor Company (which is a private limited company of the promoters of the Transferee Company) to the Punjab National Bank for the credit facilities extended to the Transferor-Company without previous approval of the Central Government. Further, it has not charged any commission/quid pro quo for extending the Corporate guarantee, which action was deemed prejudicial to the Transferee Company by the Statutory Auditors in their Report vide Annexure to the Auditors' Report dated 30-6-2007. That it may be noted that consequent to the said violation, the office of Director held by the Managing Director and other directors fell vacant as the provisions of Section 283(1)(h) of the Act stood attracted. In view of the above, the Registrar of Companies is being directed to take necessary penal action for the default under Sections 295, 297 and Section 283(1)(h) of the Act by the Transferee-Company. As the Transferee-Company is a listed public limited company, the above facts, being material having a bearing on the affairs of the company in the context of "Corporate Governance", are brought to the notice of this Hon'ble High Court. The letter dated 11-10-2008

and 17-12-2008 of M/s. Ashco Industries Limited are annexed hereto and marked as Exhibits "F-1"& "F-2".

10. The Punjab National Bank had granted a loan of Rs. 765 crores to the transferor-company which was secured inter alia by a guarantee issued by the transferee-company. It was contended that the said Ashok Kotwani and Mrs. Kotwani being directors of both the transferor and the transferee-companies, the guarantee was issued contrary to and in violation of Section 295.

11. Section 295 reads as under:

295. Loans to directors, etc.-(1) Save as otherwise provided in Sub-section (2), no company (hereinafter in this section referred to as "the lending company") without obtaining the previous approval of the Central Government in that behalf shall, directly or indirectly, make any loan to, or give any guarantee or provide any security in connection with a loan made by any other person to, or to any other person by,:

(a) any director of the lending company or of a company which is its holding company or any partner or relative of any such director;

(b) any firm in which any such director or relative is a partner;

(c) any private company of which any such director is a director, or member;

(d) any body corporate at a general meeting of which not less than twenty-five per cent of the total voting power may be exercised or controlled by any such director, or by two or more such directors together; or

(e) any body Corporate, the Board of directors, managing director, or manager whereof is accustomed to act in accordance with the directions or instructions of the Board, or of any director or directors, of the lending company.

(2) Sub-section (1) shall not apply to:

(a) any loan made, guarantee given or security provided:

(i) by a private company unless it is a subsidiary of public company, or

(ii) by a banking company;

(b) any loan made by a holding company to its subsidiary company;

(c) any guarantee given or security provided by a holding company in respect of any loan made to its subsidiary company.

12. The guarantee issued by the transferee-company in favour of the Punjab National Bank is, therefore, contrary to Section 295(1)(c).

13. Mr. Joy submitted that in view of the violation u/s 295, the said Ashok Kotwani and Mrs. Kotwani had by virtue of the provisions of Section 283(1)(h) vacated office as directors. He submitted that the resolution of the Board of

Directors of the transferee-company proposing the scheme is, therefore, void having been passed at a meeting without the requisite quorum. Accordingly, he submitted, all subsequent steps leading to this petition are void.

He further submitted that though a violation u/s 295 would not by itself be a ground for rejecting the scheme, it ought to be brought to the notice of the shareholders and creditors. In other words, Mr. Joy, relying upon Section 391(2), submitted that the moment there is a violation u/s 295 the same must be brought to the notice of the shareholders and creditors and that if the same is not done, the matter must be again placed before the shareholders and the creditors disclosing the same to seek their approval afresh.

14. Sections 391(1) and 393(1)(a) read as under:

391. Power to compromise or make arrangements with creditors and members.-

(1) Where a compromise or arrangement is proposed:

(a) between a company and its creditors or any class of them; or

(b) between a company and its members or any class of them;

the Tribunal may, on the application of the company or of any creditor or member of the company, or, in the case of a company which is being wound up, of the liquidator, order a meeting of the creditors or class of creditors, or of the members or class of members, as the case may be, to be called, held and conducted in such manner as the Tribunal directs.

(2) If a majority in number representing three-fourths in value of the creditors, or class of creditors, or members, or class of members, as the case may be, present and voting either in person or, where proxies are allowed under the rules made u/s 643, by proxy, at the meeting, agree to any compromise or arrangement, the compromise or arrangement shall, if sanctioned by the Tribunal, be binding on all the creditors, all the creditors of the class, all the members, or all the members of the class, as the case may be, and also on the company, or, in the case of a company which is being wound up, on the liquidator and contributories of the company:

Provided that no order sanctioning any compromise or arrangement shall be made by the Tribunal unless the Tribunal is satisfied that the company or any other person by whom an application has been made under Sub-section (1) has disclosed to the Tribunal, by affidavit or otherwise, all material facts relating to the company, such as the latest financial position of the company, the latest auditor's report on the accounts of the company, the pendency of any investigation proceedings in relation to the company under Sections 235 - 251, and the like.

393. Information as to compromises or arrangements with creditors and members.- (1) Where a meeting of creditors or any class of creditors, or of members or any class of members, is called u/s 391,:

(a) with every notice calling the meeting which is sent to a creditor or member, there shall be sent also a statement setting forth the terms of the compromise or arrangement and explaining its effect; and in particular, stating any material interests of the directors, managing director or manager of the company, whether in their capacity as such or as members or creditors of the company or otherwise, and the effect on those interests, of the compromise or arrangement, if, and insofar as, it is different from the effect on the like interests of other persons; and

15. The mere fact of a violation of the provisions of Sections 235 - 351 by itself does not invalidate or warrant the Court refusing to sanction a scheme of arrangement under Sections 391 - 394, including a scheme of amalgamation. It is not every violation of these sections that disentitles a scheme being proposed or sanctioned. It is only those violations which adversely reflect upon or affect the scheme that would persuade the Court not to sanction the scheme. That Section 391(2) only requires the disclosure of all material facts to the Court, establishes this. If it were otherwise, Section 391, and in particular, Sub-section (2) thereof, would have been worded differently. The purport of Section 391(2) is that all the material facts relating to the company including the pendency of any investigation proceedings in relation to the company under Sections 235 - 351 and the like, ought to be disclosed to the Court in order to enable the Court to decide whether or not the scheme ought to be sanctioned in view of such facts. The manner of exercise of discretion would then depend upon the facts of each case.

16. This is fortified by the fact that it is not necessary that a scheme under Sections 391 and 394 is proposed only by the company or its directors or promoters. It may be proposed by others also, such as the members or creditors of the company. Indeed, a scheme could also be proposed by the Official Liquidator of a company. If, for instance, there is a violation of the provisions of Sections 235 - 351 or any one or more of them by a given director, the same would not bar the company or any member or creditor of the company from proposing a scheme under Sections 391 and 394. Even if, for instance, a company is adversely affected due to any acts on the part of its directors, it would not be unusual for an arrangement to be arrived at between the company and its creditors.

17. In a given case the Court may well order any additional facts not earlier noticed, to be placed before the members and/or the creditors of the company to enable them to reconsider their decision to support the scheme. This would depend upon the answer to two questions. Is the fact a material one, to wit, is it relevant or material to the scheme that is proposed. If the answer is in the affirmative, the next question is whether there was an adequate disclosure of the facts to the members, shareholders and other concerned persons. If the answer to either of the questions is in the negative there does not arise the necessity of placing the material before the concerned persons.

18. In the present case, the fact of the guarantee issued by the transferee-company to the Punjab National Bank in respect of the loans advanced by the bank to the transferor-company and the details of the Board of Directors of both the companies would constitute material facts qua both the companies.

19. The question then is whether there was an adequate disclosure of the facts to the concerned persons. I am of the opinion that there was.

20. Firstly, I do not find the guarantee having been given by the transferee-company in respect of the facilities granted by the Punjab National Bank to the transferor-company, by itself, to warrant a refusal to the scheme being sanctioned. Mr. Joy has not indicated that the same adversely reflects upon the scheme or that it would adversely affect the members or the creditors of the companies if the scheme is sanctioned. It is not contended that the directors of the two companies had any interest in the scheme except as shareholders in general. The violation of Section 295 does not indicate the same. There is nothing on record which suggests the same either.

21. There admittedly is no investigation proceeding pending in relation to the Petitioners, under Sections 235 - 351 including under Sections 295 and 297 and the question, therefore, of disclosing the same does not arise.

22. I am satisfied that there was sufficient material before the members and the shareholders in regard to the guarantee issued by the transferee company to the Punjab National Bank and the details of the directors of the companies to have enabled them to take an informed decision as to whether the scheme ought or ought not to have been sanctioned.

(A) The Petitioners in both the Company Applications and both the Company Petitions expressly stated that they were under the same management.

(B) The Annual Report of the transferee-company for the financial year 2006-07 also contains an important disclosure. Schedule "S" containing the notes to the consolidated accounts refers to the outstanding bank guarantees under the caption "contingent liabilities". The guarantee by the transferee-company on behalf of the transferor company to the Punjab National Bank for the credit limit of Rs. 765 crores is specifically referred to therein.

Schedule "S" also contains details of "related party disclosures" as under:

7. Related party disclosures:

(i) Subsidiary.-Aschco Niulab Exports Limited.

(ii) Associate Companies.-Niulab Equipment Company Private Limited ANKK Media Arts Private Limited.

(iii) Key management personnel and relatives:

Mr. Ashok K. Kotwani, Mrs. Kanchan A. Kotwani, Mr. Bhagwan K. Kotwani, Mr. Manohar K. Kotwani, Mr. Ankuish A. Kotwani, Ms. Neha A. Kotwani, M/s. Sayuj

Telcom, M/s. Dolly Designs, Mrs. Kavita Godhwani.

[Emphasis supplied]

(C) The annexure to the Auditor's Report for the year ended 31-3-2007 discloses the opinion of the auditors that the terms and conditions on which the guarantees given by the transferee company for the loan taken by others from the bank are, prima facie, prejudicial to the company. This was a part of the 21st Annual Report for the year 2006-07 which was circulated to all the shareholders. The shareholders, therefore, had the necessary material before them regarding the guarantee.

(D) The Annual Report for the financial year 2006-07 of the transferor-company in Schedule "C", which forms part of the balance-sheet with details of secured loans, refers to the guarantee furnished by the transferee-company in respect of the facilities granted by the Punjab National Bank.

(E) The notice of the meeting convened by the Court by the aforesaid order dated 22-2-2008 in the petition filed by the transferee-company, to the shareholders and the unsecured creditors discloses the names of the said Ashok Kotwani and Mrs. Kanchan Kotwani as directors of the transferee-company as well as the transferor-company and also furnishes details of their shareholdings in both the companies. The said notices state that the directors of the transferee-company as well as of the transferor-company have no interest in the scheme except as shareholders in general.

23. In the circumstances, I see no reason to compel the facts regarding the violation u/s 295 to be placed before the members or the creditors again.

24. Mr. Joy relied upon the judgment of a learned Single Judge of the Kerala High Court in *St. Mary Finance Ltd. v. R.G. Jayaprakash* [2000] 99 Comp. Cas. 359 : [1999] 22 SCL 337. The judgment is of no relevance to the present case. In that case, the learned Judge found that the scheme itself was fraudulent, unfair and with a view to benefit another company *St. Mary's Properties Ltd.*, to which it had advanced a sum of about Rs. 7.68 crores. The scheme there proposed a compromise between the company and its creditors whereby the amount proposed to be paid to the creditors in instalments were far lower than what they were entitled to. Several creditors opposed the scheme. It was found that the relevant fact about the indebtedness of the other company had not been brought to the notice of the creditors. It was also held that a director of the company had virtually forced the creditors to issue proxies enabling him to vote in favour of the scheme on the basis of a letter circulated to the creditors, the contents whereof were found to be unfair. The advances to the other company were in fact illegal as the company was admittedly a *nidhi* company. In the passage at page 370 of the report, relied upon by Mr. Joy, it is in fact expressly held that because of the compromise there, the real beneficiary was *St. Mary's Properties Ltd.*, to whom the company had heavily advanced and that the company had withheld that valid information from the creditors. In the circumstances, it was held that

the meeting, at which the company managed to obtain through "compelled proxies" had no validity in the eye of law.

The learned Judge referred to the observations of the judgment of the Gujarat High Court in the case of Sidhpur Mills Co. Ltd., In re AIR 1962 Guj. 305 where it was observed that if the director possesses any interest of whatever kind in the scheme, then that interest must be stated in the statement accompanying the scheme. In that case, it was found that the directors, in fact, possessed an interest in the scheme other than merely as shareholders of the company and that the same had not been disclosed.

(B) In the present case, as mentioned earlier, there is nothing to indicate that the directors possessed any interest of any kind in the scheme other than as shareholders of the two companies. Further, the fact of the guarantees and the extent of the liabilities have been disclosed to the shareholders and the members as well as to the Official Liquidator, the Regional Director and the Court, which was not the case before the Kerala High Court.

25. Mr. Joy then relied upon the judgment of a learned Single Judge of this Court in KEC International v. Kamani Employees' Union [2002] 109 Comp. Cas. 659. He relied upon page 681 of the report which, in turn cited with approval the passage from the judgment of the Gujarat High Court in Sidhpur Mills Co. Ltd. "s case (supra), which was also referred to by the learned Judge of the Kerala High Court.

It is important to note the last sentence in this passage, which reads thus:

In other words, if the director possesses any interest of whatever kind in the scheme, then, that interest must be stated in the statement accompanying the scheme.

[Emphasis supplied]

I have already held that there is nothing to indicate that the directors possess any interest "in the scheme" except as shareholders of the Petitioners in general.

26. Mr. Joy further relied upon a judgment of a learned Single Judge of this Court in Bharat Synthetics Ltd. v. Bank of India [1995] 82 Comp. Cas. 437. The judgment is of no relevance. In that case, the banks who were secured creditors, contended that if the merger was allowed, their claims would be jeopardised. The learned Judge accepted this contention. The Petitioners there had not even placed before the Court the latest financial position.

(B) In the present case there is no opposition to the scheme from anyone. I have already held that the guarantee per se does not persuade me to refuse sanctioning the scheme.

27. Mr. Mehta's reliance upon the following judgments on the question of the nature of disclosure is well founded. They indicate the adequacy of the disclosure in this case.

28. In Hindustan Lever Employees Union Vs. Hindustan Lever Ltd. and others, , the Division Bench affirmed the judgment of the learned Single Judge including the observations that the disclosure u/s 393(1)(a) is not the same as the disclosure to be made u/s 173. u/s 173, all material facts mentioned therein must be stated. However, u/s 393(1)(a) the statement must clearly state the compromise and arrangement, its effect and the manner in which the material interest of specified categories of persons in any capacity, are likely to be affected by the scheme in case the effect is different from the effect on the like interest of non-specified categories of persons. The Division Bench further held that the purpose of such disclosure is to enable the shareholders to make their objections and that every nondisclosure is not fatal unless it is fraudulent and has prejudicially affect the decision-making process of the members.

In the present case, there is nothing that suggests any fraud. Nor is there anything that suggests that the disclosure already made did not enable the creditors and the members to make a informed decision.

29. The above judgment was affirmed by the Supreme Court in Hindustan Lever Employees" Union Vs. Hindustan Lever Limited and others, . In paragraph 58, the Supreme Court held as under:

58. In the facts of this case, considering the overwhelming manner in which the shareholders, the creditors, the debenture-holders, the financial institutions, who had 41 per cent shares in TOMCO, have supported the Scheme and have not complained about any lack of notice or lack of understanding of what the Scheme was about, we are of the view, it will not be right to hold that the explanatory statement was not proper or was lacking in material particulars.

30. I am satisfied that the disclosures made in the present case enabled the members and the creditors to make a informed decision which they did while supporting the scheme. There has been no opposition to the scheme being sanctioned by anyone. Indeed, even the Regional Director does not oppose the scheme as such.

I do not find the violation u/s 295 to have any bearing on the scheme such that I ought to overrule the decision of all those who desire it to be implemented including the members and creditors of both the companies. It is not even contended before me that the scheme itself is only to benefit the concerned directors or any other particular person or persons.

31. Mr. Joy merely submits that the meetings must be convened once again, specifically stating that there is a violation u/s 295.

32. I do not agree. The members and the creditors already had the relevant information including about the facts of the guarantee and the names of the directors of both the companies.

33. This brings me to Mr. Joy's submission that in view of the violation of Section 295 the concerned directors viz. Mr. and Mrs. Kotwani had vacated office as

directors by virtue of the provisions of Section 283(1)(h), which reads as under:

283. Vacation of office by directors.-(1) The office of a director shall become vacant if:

(h) he whether by himself or by any person for his benefit or on his account, or any firm in which he is a partner or any private company of which he is a director, accepts a loan, or any guarantee or security for a loan, from the company in contravention of Section 295;

Mr. Joy submitted that in that event there was no quorum at the meeting of the Board of Directors on 20-11-2007 whereat the scheme was proposed. Article 166(a) of the Articles of Association of the transferee company reads as under:

166(a). The quorum for a meeting of Directors shall be one-third of the total strength of Directors (any fraction contained in that one-third being rounded off as one) or two Directors whichever is higher provided that where at any time the number of interested Directors exceeds or is two-thirds of the total strength, the number of the remaining Directors that is to say, the number of Director who are not interested present at the meeting being not less than two shall be the quorum during such time.

The submission really ought to be that, in that event, there was not a validly constituted Board of Directors of the transferee company in view of Article 133 of the Articles of Association of the company which reads as under:

133. The number of Directors shall not be less than three or until otherwise determined by a General Meeting, more than twelve, excluding the debenture director if any.

If the two directors had vacated office there were only two directors of the transferee company.

34. Mr. Mehta submitted that the directors have not vacated office u/s 283(1)(h). He further submitted that one of the directors, Mrs. Kanchan Kotwani had in any event been reappointed as a director after she allegedly vacated office and that thereby there were at least three directors on the Board of Directors of the transferee company and at the meeting held on 20-11-2007. Lastly, he submitted that even if these two submissions are answered against him the resolution at the meeting of the Board of Directors is not void in view of Section 290.

35. Mr. Mehta submitted that even assuming that there was a violation of Section 295 on account of the transferee company having furnished a guarantee in favour of the Punjab National Bank in respect of the loans advanced to the transferor company, the said directors, Mr. Ashok Kotwani and Mrs. Kanchan Kotwani had not vacated their office u/s 283(1)(h). According to him, Section 283(1)(h) does not apply to such a case.

He submitted that in the facts of the present case the private company viz., the

transferor company of which they are directors, had not accepted a loan from the transferee company nor a guarantee for a loan from the transferee company. In other words, according to him, while Section 295 renders several transactions impermissible, Section 283(1)(h) renders the directors liable to vacate office only in certain cases, covered by Section 295.

36. Mr. Mehta's submission is well founded. There are various transactions u/s 295 which are impermissible without the previous approval of the Central Government, only some of which are specified in Section 283(1)(h). Thus, u/s 283(1)(h) the office of a director does not become vacant for any violation of Section 295. It becomes vacant only in the limited category of cases specified therein.

37. A view to the contrary would require re-writing Section 283(1)(h) which is not permissible. Indeed, if that was the intention of the Legislature, Section 283(1)(h) would merely have provided that the office of the director becomes vacant if he contravenes Section 295.

There is nothing in Section 283 or in Section 295 which warrants expanding the scope of Section 283(1)(h).

38. This view is supported by the fact that u/s 283(1)(i) the office of a director shall become vacant if "he acts in contravention of Section 299". Section 299 requires a disclosure of interests by a director. There are different interests specified in Section 299. For instance, it requires a disclosure by a director of his interest not merely of a contract or arrangement but even in respect of a proposed contract or a proposed arrangement entered into or to be entered into by or on behalf of the company. u/s 283(1)(i), the office of a director becomes vacant for any contravention of Section 299. The disability u/s 283(1)(i) operates in respect of any contravention of Section 299. In contrast, u/s 283(1)(h) a director incurs the disqualification only in respect of certain contravention u/s 295 and not all.

39. Thus, when there is a contravention of Section 295 it is necessary to examine whether it falls within the ambit of Section 283(1)(h) or not. If it does not, the office of the director does not become vacant merely because there was a contravention of Section 295.

40. In the present case, there is indeed a contravention u/s 295(1)(c). u/s 295, no company shall give any guarantee in connection with a loan made to any other person by any private company, of which any such director is a director or member. The expression "any such director" refers to a director of the lending company. In the present case, the said Mr. and Mrs. Kotwani were directors of both the companies. Thus, the transferee company was prohibited from giving any guarantee in connection with a loan made by any other person viz, Punjab National Bank to any private company viz, the transferor company, of which the said Mr. and Mrs. Kotwani were directors and members. However, Section 283(1)(h) does not include within its scope such a contravention of Section 295. Neither

the said Mr. and Mrs. Kotwani nor the transferor company accepted any guarantee for a loan from the company.

41. Thus, neither Mr. nor Mrs. Kotwani vacated office as directors of either the transferor company or the transferee company.

42. Mr. Mehta further submitted that even assuming that Mr. and Mrs. Kotwani had vacated office as directors of the transferee company, there was a validly constituted Board of Directors and that there was present the requisite quorum, at the said meeting held on 20-11-2007.

43. The transferee company had issued the guarantee on 5-6-2006. On this date, there were five directors on the Board of the transferee company. Two of them viz. Ashok Kotwani and Mrs. Kanchan A. Kotwani were also directors of the transferor company. Even assuming that they vacated the office of directors of the transferee company by virtue of Section 283(1)(h) the transferee company had three other directors viz. Biswajit Ghosal, Krushnakant Dharia and R. Rajangam. The said R. Rajangam and Krushnakant Dharia resigned as directors with effect from 30-6-2006 and 30-6-2007 respectively. One Rajesh Nawathe and one Shashin Shah were appointed as additional directors of the transferee company on 30-6-2007. They were subsequently appointed as directors of the transferee company at the Annual General Meeting held on 28-9-2007.

At the Annual General Meeting the said Mrs. Kanchan A. Kotwani was again appointed as a director of the transferee company. Mr. Mehta submitted therefore that even assuming that she had vacated office on 5-6-2006, she was re-appointed on 28-9-2007.

(B) On 20-11-2007 the said Mrs. Kanchan A. Kotwani, Rajesh Nawathe and Shashin Shah were directors of the transferee company and in any event, functioned as such. In the affidavit dated 5-3-2009, apart from stating the above facts, it is expressly stated that these three directors and the said Ashok Kotwani had attended the meeting held on 20-11-2007. Thus, according to Mr. Mehta therefore, at least three validly appointed directors were present at the meeting held on 20-11-2007.

44. Mr. Mehta therefore contended that, in any event, there was a validly constituted Board of Directors of the transferee company and that the resolution was passed validly on 20-11-2007.

45. Mr. Joy however contended that if Section 283(1)(h) applies to the said two directors, the re-appointment of Mrs. Kanchan A. Kotwani is in any event bad as it was sought to be done u/s 256(3) which was not applicable inasmuch as she could not be deemed to have retired on that date, having earlier vacated office as a director. In that event, she ought to have been appointed following the procedure u/s 257.

46. I heard counsel at some length on this question of law raised by Mr. Mehta viz., that even assuming that the said directors had vacated their office u/s

283(1)(h) there was a validly appointed and functioning Board of Directors of the transferee company and at the meeting held on 20-11-2007 there was the requisite quorum as Mrs. Kanchan Kotwani had in any event been re-appointed at the AGM held on 28-9-2007.

47. It is not necessary to decide this question of law in the present case. Even assuming Mr. Joy's submissions on both the points are correct, it would make no difference to the validity of the resolution dated 20-11-2007. Mr. Mehta's reliance upon Section 290 of the Companies Act in this regard is well founded. Section 290 of the Companies Act reads as under:

290. Validity of acts of directors.-Acts done by a person as a director shall be valid, notwithstanding that it may afterwards be discovered that his appointment was invalid by reason of any defect or disqualification or had terminated by virtue of any provision contained in this Act or in the articles:

Provided that nothing in this section shall be deemed to give validity to acts done by a Director after his appointment has been shown to the company to be invalid or to have terminated.

48. The least that must be said in favour of Mr. Mehta's submissions, specially as regards the applicability of Section 283(1)(h), is that it is more than just an arguable case.

49. The term "terminated" would include a director vacating office by virtue of Section 283. This is clear from the words of Section 290:

...had terminated by virtue of any provision contained in this Act....

In that event, what is important to note is that, it can hardly be suggested that the said two directors were cognizant or aware of the view that their appointment had terminated. They quite obviously were oblivious of their alleged disqualification. Had they been aware of the same they would have taken steps to remedy the defect. There was no reason whatever for them to let the invalidity continue.

I have no reason to believe that it had been shown to the transferee company or its directors that the appointment of the said directors had terminated. The mere fact that they knew the facts constituting the disability or invalidity does not lead to an inference in this case that they were aware of the consequences of these facts.

In that view of the matter, the proviso to Section 290 would not operate to invalidate the acts of these two directors, done in the meantime.

50. There is nothing to indicate that at the relevant time i.e., on 20-11-2007 it had been shown to the company or the said directors that their appointment as directors had terminated. The Auditor's Report indicates a violation u/s 295. That by itself does not operate the proviso to Section 290 against the Petitioners. The real question is whether the company/its directors were cognizant or aware

that they had vacated office in view of Section 283(1)(h). I think not.

51. The question about the said directors vacating the office was raised for the first time only in the affidavit filed on behalf of the Regional director. Indeed, whether Section 283(1)(h) applies at all is a moot question. The proviso to Section 290 does not operate in the present case in view of the fact that there is nothing to indicate that the company or either of the directors were of the view or had been informed/shown by anyone that their appointment had been terminated by virtue of the provisions of Section 295 read with Section 283(1)(h).

52. Section 290 is vide in its scope. This is clear from the words:

invalid by reason of any defect or disqualification

and the words:

had terminated by virtue of any provision contained in this Act or in the articles.

53. Further, the scheme operates not merely qua the directors but all the members and the creditors of both the companies.

54. Section 290 would also be applicable in cases such as this where directors act despite there not being the minimum number of directors required by the Articles of Association as a consequence of one or more of the directors vacating office for any reason, such as, u/s 283. There is no warrant to curtail the ambit of Section 290 by excluding such cases.

55. Thus, even assuming that the required number of directors were not present at the meeting held on 20-11-2007 the same would not invalidate the resolution.

56. In *Shiromani Sugar Mills Ltd. Vs. Debi Prasad*, , it was contended that the directors who voted for the allotment of shares were disqualified to act as such directors and that the allotment was therefore ultra vires and of no effect. It was found that the directors not having acquired the qualification shares had indeed ceased to be directors u/s 85 of the Indian Companies Act, 1913. Consequently, the resolutions allotting the shares and making a call for the money were passed in a meeting in which there was no quorum.

The Official Liquidator relied upon Article 181 which it was held was couched in the same words as Section 86 of the Indian Companies Act, 1913. It would be useful at this stage to set out Article 181 and Section 86 which read as under:

Article 181. All acts done by any committee of Directors or by any person acting as a Director shall, notwithstanding that it be afterwards discovered that there are some defects in appointments of any such directors or persons acting as aforesaid or that they or any of them are disqualified, be as valid as if every such person have been duly appointed and was qualified to be a Director.

Section 86 of the 1913 Act:

The acts of a director shall be valid notwithstanding any defect that may

afterwards be discovered in his appointment or qualification:

Provided that nothing in this section shall be deemed to give validity to acts done by a director after the appointment of such director has been shown to be invalid.

The Division Bench held as under:

The Official Liquidator relied upon Article 181 which is couched in the same words as Section 86, Companies Act, 1913, by which we are governed in these applications. This article, widely worded as it is, supports his contention that in spite of the disqualifications of the Directors the resolutions passed by them are valid. In *Hallows v. Fernie* 1867-3 Ch. A 467 : 18 L.T. 340 the objection to the allotment of shares on the ground that the Directors who made the allotment did not possess the requisite-share qualification, was overruled on the basis of a provision in the English Companies Act similar to that contained Section 86, Indian Companies Act. In *Dawson v. African Consolidated Land and Trading Co.* [1898] 1 Ch. 6 : 67 L.J. Ch. 47 a call made by Nielson a Director, was upheld though he had parted with all his shares and thus become disqualified and was not re-elected as such on acquiring fresh shares before the call was made. Chitty L.J. emphasised the words "some defect in the appointment" and expressed the view that the provision is not so framed as to render valid a resolution passed by any person who without a shadow of title assume to act as Directors of a company. There was no defect in the appointment of Nielson as Director; he only became disqualified subsequently on his parting with his shares. His acting as Director in spite of the disqualification was held to be exactly within the words of the article and one of those defects, irregularities or whatever else one ought to call them; which are remedied by Article 114 which is in almost the same words as our Article 181. An identical article again came up for discussion in *British Asbestos Co. Ltd. v. Boyd* (1903) 2 Ch. 439 : 73 L.J. Ch. 31. Farwell J. stated at page 444:

It is not, therefore, that the facts are not known, but that the knowledge of the defect is not present to the mind of any person to whom it is material at the time to know it. As it is put in Buckley on the Companies Acts, 8th Edn., p. 230, the object of an article like this and Section 67 of the General Act, is to make the honest acts of de facto Directors as good as the honest acts of de jure Directors.

In the present case, the directors certainly knew that they had not paid the allotment and call moneys, but there is nothing to indicate that the fact that they had thereby disqualified themselves was present to their minds at the time when they allotted the shares and made the calls. There was no defect in their appointment as Directors; the only defect is that they continued to act as Directors even after their disqualification. There is no suggestion that they acted dishonestly in passing the resolutions of allotment and making the calls. It seems that they acted bona fide, oblivious of the fact of their disqualification. There is no evidence of the fact of their disqualification having ever been brought to their minds. The language of Article 181 fully protects their actions. Had it been a case

of only one or to Directors continuing to act as such despite the disqualification, I would have had no hesitation in forming the conclusion that I have. Here we have to deal with a large number of Directors acting as such despite the qualification. But there is no other circumstance from which it can be said that they were conscious of the fact of their disqualification and yet continued to act as Directors. So I come to the conclusion, though not without some hesitation that the acts of allotting the shares to the opposite parties and making the first and second calls were valid.

57. I am in respectful agreement with the judgment of the Division Bench of the Allahabad High Court. Although Section 86 of the 1913 Act did not deal with the cases where the appointment of a person as a director is terminated but dealt only with cases where the appointment was invalid, the ratio of the judgment would apply equally even in the cases where the appointment has been found to be terminated by virtue of Section 283. The purpose of Section 290 is to ensure that acts done bona fide are not annulled as the same would adversely affect the rights of various third parties as well. In any event, Article 181 which was relied upon by the Division Bench is similar to Section 290.

58. Mr. Mehta's reliance upon the judgment of the Supreme Court in Mohan Lal and Another Vs. Grain Chamber Ltd., Muzaffarnagar and Others, , is also well founded. The Supreme Court having held that Regulation 94 of Table A was deemed to be incorporated in the articles of the company held as under:

13. ...It, therefore follows that Regulation 94 must be deemed to be incorporated in the Articles of Association of the Company. That Regulation provided:

All acts done by any meeting of the directors or of a committee of directors, or by any person acting as a director shall, notwithstanding that it be afterwards discovered that there was some defect in the appointment of any such directors or persons acting as aforesaid or that they or any of them were disqualified, be as valid as if every such person had been duly appointed and was qualified to be a director.

There is no evidence that the directors were aware of the disqualification which would be incurred by entering into contracts of sale or purchase or supply of goods with the company without the express sanction of the directors. By the subsequent discovery that they had incurred disqualification, because they had entered into contracts with the company for sale or purchase or supply of goods, the resolution passed by them is not rendered invalid. It is in the view we have taken, unnecessary to decide whether Section 86 of the Indian Companies Act, 1913 also grants protection to acts done by directors who are subsequently discovered to be disqualified.

59. Thus, in any view of the matter the resolution dated 20-11-2007 is saved and cannot be held to be void.

60. It is however clarified that this order sanctioning the scheme will not in any

manner affect any action that may be taken by any authorities for the contravention of Section 295 or 297 or the contentions of such authorities on any application that may be made by the company or the concerned director for compounding.

61. (i) In the circumstances, the Company Petition No. 382 of 2008 is made absolute in terms of prayers (a) to (j) and Company Petition No. 382 of 2008 is made absolute in terms of prayers (a) to (i).

(ii) The Petitioner companies to pay costs of Rs. 7,500 each to the Regional Director and to the Official Liquidator, High Court, Bombay within six weeks from today.