
(1976) 04 GUJ CK 0001

In the Gujarat High Court

Case No : Company Petition No"s. 20 to 23 of 1975 with Company Application No"s. 53 to 56 of 1974

In Re: Shahibag Entrepreneurs P. Ltd. and Others

Date of Decision : 21-04-1976

Acts Referred:

Companies Act, 1956 — Section 391, 394, 394(1)

Citation : (1976) 46 CompCas 642

Hon'ble Judges : B.K. Mehta, J

Bench : Single Bench

Advocate : R.H. Mehta, for Company and A.M. Setalwad, for Central Govt, for the Appellant;

Judgement

Mehta, J.—This group of company petitions is made to obtain sanction of this court to arrangement effected between Karamchand Premchand Private Limited having its registered office at Shahibag, Ahmedabad; Bakubhai Ambalal Private Limited, having its registered office at Shahibag House, 13, Mulchand Hirachand Marg, Ballard Estate, Bombay; Mauj-E-Dariya Estate Private Ltd., having its registered office at Shahibag House, Shahibag, Ahmedabad, and Koba Farm Private Limited, having its registered office at Shahibag House, Shahibag, Ahmedabad (hereinafter called for the sake of convenience as "the transferor-companies") and Shahibag Entrepreneurs Private Limited, having its registered office at Shahibag House, Shahibag, Ahmedabad (hereinafter called for the sake of convenience as "the transferee-company") u/s 391 read with section 394 of the Companies Act, 1956, on the terms and conditions detailed in the scheme of amalgamation, the broad features of which are set out hereinbelow, with effect from January 1, 1974, subject to the liabilities, duties and covenants in the said scheme, inter alia, for vesting the assets of the transferor-companies in the transferee-companies without further act or deed, and for the dissolution of the transferor-companies without-up.

* * * * 2. The transferee-company has still to commence its activities and since none of the transferor or transferee-companies is an undertaking within the meaning of the Monopolies and Restrictive Trade Practices Act, 1969, inasmuch

as they are investment companies and because the beneficial ownership of the shares of all the five companies are held by common share-holders, the merger of the transferor-companies with the transferee-company is considered desirable in order to have economic and efficient functioning of one investment company only with a view to avoid multiplicity of administration, accounting, secretarial and personnel costs. The directors, therefore, were of the unanimous opinion that the scheme of amalgamation would be in the interest of each of the company and their respective shareholders. The scheme of amalgamation was, therefore, proposed and unanimously approved by the board of directors of all the five companies. It should be noted that one of the transferor-companies namely, Karamchand Premchand Pvt. Ltd. holds share in another transferor-company, Bakubhai Ambalal Pvt. Ltd. Similarly, the transferor-companies, Mauj-E-Dariya Estate Pvt. Ltd. and Koba Farm Pvt. Ltd., holds shares in Karamchand Premchand Pvt. Ltd. Bakubhai Ambalal Pvt. Ltd. holds shares in Karamchand Premchand Pvt. Ltd. and owns the totality of shares in Mauj-E-Dariya Estate Pvt. Ltd. and Koba Farm Pvt. Ltd. as stated above.

* * * * 3. The official liquidator was of the opinion that having regard to the affairs of Karamchand Premchand Private Ltd., the exchange ratio prescribed under the scheme of amalgamation for every shareholder of Karamchand Premchand Pvt. Ltd. in the shares of the transferee-company was unreal without regard to the real value of the share of the transferor-company, Karamchand Premchand Pvt. Ltd., and to the extent to which the prescribed ratio was based on under-valuation of the real assets by about Rs. 10,49,34,838.34, the directors have conducted the affairs of the transferor-company, Karamchand Premchand Pvt. Ltd., in a prejudicial manner. Similarly, the official liquidator made a qualified report in respect of the transferor-company, Mauj-E-Dariya Estate Pvt. Ltd., and Koba Farm Pvt. Ltd.

* * * * 4. I may set out a few facts and circumstances so as to find out whether there is any justification for the objection of the official liquidator in connection with the conduct of the affairs of the said company which affected the prescription of the exchange ratio in the scheme of amalgamation.

5. The transferor-company, Karamchand Premchand Pvt. Ltd., acted as managing agents of one of the reputed textile Mills, namely, Ahmedabad Manufacturing and Calico Printing Co. Ltd., popularly known as "Calico Mills" which was incorporated on November 20, 1880. Besides, the transferor-company, Karamchand Premchand Pvt. Ltd., was engaged in manufacturing various kinds of goods. Its different manufacturing activities were carried on principally through four divisions, namely, (1) Sarabhai Chemicals; Sarabhai Common Services and Sarabhai Marketing Services; (2) Swastik Oil Mills; (3) Sarabhai Engineering Group (Sarabhai Machinery) and (4) Sarabhai Glass. Sarabhai Chemicals, Sarabhai Common Services and Sarabhai Marketing Services of division (1) and Sarabhai Engineering Group of division (3) and Sarabhai Glass of division (4) were initially started to supplement and augment the manufacturing activities

carried on by Sarabhai Chemicals of Division (1). But in course of time the aforesaid former divisions built up separate industrial activities for themselves. Apart from catering to the needs of Sarabhai Chemicals and working as a workshop thereof, these divisions started catering to the needs of other industries and supplying products to others. With a view to achieving maximum operating efficiency, economy and optimum utilisation of Government resources through more concerted efforts, in the meeting of the board of directors of Karamchand Premchand Pvt. Ltd. held on June 29, 1973, it was proposed to transfer the following business of the company to its wholly-owned subsidiaries as going concerns :

(1) The business of Sarabhai Chemicals, Sarabhai Common Services and Sarabhai Marketing Services were proposed to be transferred to Sarabhai Chemicals Pvt. Ltd., Baroda.

(2) The business of Swastik Oil Mills was proposed to be transferred to Swastik Household and Industrial Products Pvt. Ltd., Bombay.

(3) The business of Sarabhai Engineering Group (Sarabhai Machineries) was proposed to be transferred to Fabriquip Pvt. Ltd., Boroda.

(4) The business of Sarabhai Glass was proposed to be transferred to Packart Pvt. Ltd.

6. The aforesaid four private limited companies were incorporated as wholly owned subsidiaries of the transferor-company, Karamchand Premchand Pvt. Ltd. and from June 30, 1973, all the rights, properties, goodwill and liabilities of the aforesaid respective divisions of Karamchand Premchand Pvt. Ltd. were transferred to these wholly-owned subsidiaries. Since then the transferor-company, Karamchand Premchand Pvt. Ltd., is left purely with investment activity and is functioning as an investment company. At the time of transfer of these aforesaid respective divisions, to the aforesaid new subsidiaries with effect from 30th June, 1973, the goodwill of the aforesaid division was certified by the auditors, M/s. Sorab S. Engineer & Co., Bombay, at Rs. 10,00,00,000. The purchase consideration agreed by the aforesaid four subsidiary companies for taking over the business of the aforesaid divisions of Karamchand Premchand P. Ltd. was in all Rs. 11,23,80,001.27. The break-up of the goodwill and of the purchase consideration as agreed between the parties for the transfer of the respective four divisions of Karamchand Premchand P. Ltd. are as mentioned in the report of the official liquidator as well as the chartered accountants, M/s. Mahendra N. Shah & Co., of Ahmedabad. It appears from the report of the chartered accountants that only a part of the consideration for transfer of the aforesaid divisions by the transferor-company, Karamchand Premchand Pvt. Ltd., to its subsidiaries was received in cash and by adjustment against the share capital of the aforesaid subsidiaries subscribed by the transferor-company, Karamchand Premchand Pvt. Ltd., while the payment of a substantial part of the consideration was deferred and receivable in 6 to 8 annual installments. In July,

1973, 22 wholly-owned subsidiary companies of the transferor-company, Karamchand Premchand Pvt. Ltd., were incorporated. This group of subsidiary companies was known as "Ambernath Group of Companies". Transferor-company, Karamchand Premchand Pvt. Ltd., transferred its certain investments of the value of Rs. 9,97,77,716 to this Ambernath Group of companies which included 30,00,000 equity shares of Sarabhai Chemicals Pvt. Ltd., 1,50,000 equity shares of Swastik Household and Industrial Products Ltd., 50,000 equity shares of Fabriquip Ltd. and 30,000 equity shares of Packart Pvt. Ltd., of Rs. 100 each, besides 1,08,478 equity shares of Calico Mills of Rs. 125 each and 10,000 equity shares of Sarabhai Research Ltd., of Rs. 100 each. Transferor-company, Karamchand Premchand Pvt. Ltd., also assigned a book debt amounting to Rs. 10,98,88,920 to this Ambernath Group of companies. In other words, Karamchand Premchand Pvt. Ltd. sold to Ambernath Group of companies the assets amounting to Rs. 2,08,66,636 in lieu of which Ambernath Group of companies allotted to Karamchand Premchand Pvt. Ltd. Rs. 20,92,996 equity shares of Rs. 100 each fully paid up. Again, in the same period, namely, July, August, 1973, the transferor-company, Karamchand Premchand Pvt. Ltd., formed another group of 22 wholly-owned subsidiary investment companies which is known as "Cauvery Group of 22 Companies". It appears that Karamchand Premchand Pvt. Ltd. transferred its holding of Rs. 20,92,996 equity shares in Ambernath Group of companies to this Cauvery Group of companies in or about December, 1973, in lieu of which Cauvery Group of companies allotted 10,43,634 equity shares of its various companies of Rs. 100 each to the transferor-company, Karamchand Premchand Pvt. Ltd. It is this transfer which has been objected to by the official liquidator which in his opinion amounts to prejudicial conduct of the affairs of the company inasmuch as the transferor-company, Karamchand Premchand Pvt. Ltd., has by the last transfer of its shareholding in Ambernath Group of companies to Cauvery Group of companies attempted to undervalue its real assets by about Rs. 10,49,34,838.34 contrary to all known and accepted principles of valuation of shares in practice of accountancy, though the real value of investment and the book debts of the transferor-company, Karamchand Premchand Pvt. Ltd., amounting to Rs. 20,86,66,636 is not reduced in its real value as it could not have in the short period of about 4 to 6 months, namely, July-August, 1973, when these two groups, namely, Ambernath Group of Companies and Cauvery Group of companies were incorporated, to December, 1973, when the last transfer was effected by Karamchand Premchand Pvt. Ltd.

* * * * 7. In the context of the above rival averments a question arises, whether it can legitimately be said that the directors have conducted the affairs of the company in a manner which is prejudicial to the shareholders or to the public interest at large. The only grievance made on behalf of the official liquidator is as to the exchange ratio fixed in the proposed scheme for the shares of the transferor-company, Karamchand Premchand Private Ltd., by undervaluing the real assets of the transferor-company by paper transfer of the assets thereof to its various subsidiaries in turn. So far as the question of public interest is

concerned, I do not think that the official liquidator can make a grievance in view of the admitted position that the basis of the valuation adopted was one which is recognized in the rules framed under the Wealth-tax Act for the purposes of the said Act. No grievance can, therefore, be made that the basis of the valuation is arbitrary or unreasonable. It was contended on behalf of the transferor-company and transferee-companies by the learned counsel, Mr. Setalwad, that the official liquidator while making the report under the second proviso to section 394(1)(iv) was not concerned with the scheme and its detailed provisions as appears to be clear from the comparison of the nature of the two fetters prescribed in the first and second provisos to section 394(1)(iv). I do not think it necessary to go into this larger question canvassed by the learned counsel in view of the admitted position in the report of the chartered accounts appointed by the official liquidator which goes to show clearly that the grievance of the official liquidator that the affairs of the transferor-company, Karamchand Premchand Pvt. Ltd., have been prejudicially conducted either from the standpoint of the shareholders or public at large (sic).

* * * * 8. In view of the unequivocal opinion, of the chartered accountants appointed by the official liquidator himself, I do not think that it can be established successfully that the directors of the transferor-company, Karamchand Premchand Pvt. Ltd., had conducted the affairs of the company in a prejudicial manner from the standpoint of the shareholders or the public at large.

9. Apart from this opinion of the chartered accountants appointed by the official liquidator, the transferor-company, Karamchand Premchand Pvt. Ltd., has clearly brought out in the affidavit-in-rejoinder of its secretary, Mr. P. N. Shah, that there was no under-valuation of the assets of Ambernath Group of companies and it has been rightly pointed out that the part of the assets of Ambernath Group of companies comprising of book debts were receivable within a period of 6 to 8 years in equal annual installments. For ascertaining the present value of the said book debts payable within a period of 6 to 8 years the discounting factor has got to be applied. The objection of the official liquidator that the valuation method adopted by Anil Shah for valuing the shares of Ambernath Group of companies was wrong and he ought to have adopted the break-up method is also not well-founded, obviously for two reasons, firstly, the maintainable profit basis method is one of the recognized methods for valuation of shares; and, secondly, the break up value method is generally adopted when a company is on its eve of winding-up. The principles which emerged from the judicial decisions in the matter of approach to different methods of valuation have been set out succinctly in the book "Valuation of Shares" by Adamson, fifth edition, at page 67 of Chapter 7, dealing with Judicial Methods of Approach. Principles Nos. 2,3 and 4 are relevant for the purpose of the discussion on hand. They are :

1.

2. The assessment value must be based mainly upon the income yield, but with some regard to the assets backing in special cases.

3. Assets backing is of more importance in the case of a majority shareholding than in a minority shareholding, and is more useful in investment companies than in trading companies as a check on value determined from earning capacity.

4. Earning capacity or maintainable profits are not synonymous with the yield or return, which is the balance remaining therefrom after providing a reasonable reserve.

10. In *Commissioner of Wealth-tax v. Mahadeo Jalan*, a question arose before the Supreme Court, whether the Appellate Tribunal was justified in law to follow the method involving the principle of "break-up value" instead of the method involving the principle of "yield value" in determining the value of the shares u/s 7 of the Wealth-tax Act. The High Court of Assam and Nagaland had taken the view that the Tribunal was not justified in adopting the break-up value method as the basis of the valuation. In that context Jaganmohan Reddy J., speaking for the court, observed as under at page 633 :

"An examination of the various aspects of valuation of shares in a limited company would lead us to the following conclusion :

(1) Where the shares in a public limited company are quoted on the stock exchange and there are dealings in them, the price prevailing on the valuation date is the value of the shares.

(2) Where the shares are of a public limited company which are not quoted on a stock exchange or of a private limited company, the value is determined by reference to the dividends, if any, reflecting the profit-earning capacity on a reasonable commercial basis. But, where they do not, then the amount of yield on that basis will determine the value of the shares. In other words, the profits which the company has been making and should be making will ordinarily determine the value. The dividend and earning method or yield method are not mutually exclusive; both should help in ascertaining the profit earning capacity as indicated above. If the results of the two methods differ, an intermediate figure may have to be computed by adjustment of unreasonable expenses and adopting a reasonable proportion of profits.

(3) In the case of a private limited company also where the expenses are incurred out of all proportion to the commercial venture, they will be added back to the profits of the company in computing the yield. In such companies the restriction on share transfers will also be taken into consideration as earlier indicated in arriving at a valuation.

(4) Where the dividend yield and earning method break down by reason of the company's inability to earn profits and declare dividends, if the set-back is temporary then it is perhaps possible to take the estimate of the value of the shares before set-back and discount it by a percentage corresponding to the proportionate fall in the price of quoted shares of companies which have suffered similar reverses.

(5) Where the company is ripe for winding up then the break-up value method determines what would be realised by that process.

(6) As in *Attorney-General of Ceylon v. Mackie* a valuation by reference to the assets would be justified whereas in that case the fluctuations of profits and uncertainty of the conditions at the date of the valuation prevented any reasonable estimation of prospective profits and dividends.

In setting out the above principles, we have not tried to lay down any hard and fast rule because ultimately the facts and circumstances of each case, the nature of the business, the prospects of profitability and such other considerations will have to be taken into account as will be applicable to the facts of each case. But, one thing is clear, the market value, unless in exception circumstances to which we have referred, cannot be determined on the hypothesis that because in private limited company one holder can bring it into liquidation, it should be valued as on liquidation, by the break-up method. The yield method is the generally applicable method while the break-up method is the one resorted to in exceptional circumstances or where the company is ripe for liquidation but none the less is one of the methods."

11. In view of this legal position, the assertion of the official liquidator that Shri Anil Shah should have adopted the break-up value method is not well-founded merely because this is a private limited company.

12. It appears that after the report of the official liquidator making a grievance about the unreal exchange ratio fixed between the transferor and transferee-companies, as in the opinion of the official liquidator there is an undervaluation of the assets of the Ambernath Group of companies, the transferor-company, Karamchand Premchand Private Limited, referred the matter to M/s. S. V. Ghatalia & Co., a leading firm of accountants and valuers. The said firm has also valued the shares of Karamchand Premchand Private Limited on the basis of profit earning capacity thereof, and on the basis of earning power they worked of the value of equity shares at Rs. 2,537.05 per share. The said firm has expressed the view that the fair and reasonable ratio between the equity shares of Karamchand Premchand Private Limited and equity shares of the transferee-company, Shahibag Entrepreneurs Pvt. Ltd. is 40 equity shares of Rs. 100 each of the transferee-company for one share of Rs. 1,000 each of the transferor-company, Karamchand Premchand Pvt. Ltd. The official liquidator has also lost sight of the fact that the exchange ratio is to be determined between the shares of Karamchand Premchand Pvt. Ltd. and the other transferor-companies on the one hand and that of the transferee-company, Shahibag Entrepreneurs Pvt. Ltd., on the other. In fixing the exchange ratio between the said transferor-company and the transferee-company the value of the shares Ambernath Group of companies was not very much relevant. The exchange ratio which has been fixed between Karamchand Premchand Pvt. Ltd. and the transferee-company was on the basis of the report of M/s. Sorab S. Engineer and Co. who had valued the equity shares of Karamchand Premchand Pvt. Ltd. at Rs. 3,600 per share, and on

that basis, in the scheme, it has been provided that 36 equity shares of Rs. 100 each of the transferee-company were to be allotted for one equity share of Rs. 1,000 of the transferor-company, Karamchand Premchand Pvt. Ltd. It should be recalled that M/s. S. V. Ghatalia & Co., on the basis of the earning capacity of the transferor-company, Karamchand Premchand Pvt. Ltd., worked out at Rs. 4,000 per share and on that basis they suggested the exchange ratio of 40 shares of the transferee-company for one share each of Karamchand Premchand Pvt. Ltd. The difference of Rs. 400 per share between the valuation of M/s. Sorab S. Engineer & Co. and M/s. S. V. Ghatalia is marginal and is due to the different approach of the experts. In that view of the matter, I do not think that the official liquidator was entitled to make the grievance that the affairs of the transferor-company, Karamchand Premchand Pvt. Ltd., were managed prejudicially from the standpoint of the shareholders. As a matter of fact after this affidavit-in-rejoinder of the transferor-company, Karamchand Premchand Pvt. Ltd., was filed in this court, the official liquidator has filed an additional report dated January 15, 1976, and stated as under in paragraph 2 thereof :

"Thereafter, Shri P. N. Shah, secretary of the company, filed his affidavit-in-reply dated October 1, 1975. In the said affidavit-in-reply, report of M/s. S. V. Ghatalia & Co., chartered accountants, for determination of exchange ratio on equity shares was annexed. On personal of the said report and on reply of my further inquiry as to the 92 per cent. rate of capitalisation adopted by M/s. S. V. Ghatalia & Co. chartered accountants, I am of the opinion that the exchange ratio as proposed in the scheme of amalgamation appears to be reasonable."

13. In view of this additional report, therefore, the objection of the official liquidator no more survives.