

(2009) 03 GUJ CK 0080

In the Gujarat High Court

Case No : C.P. No. 242 of 2008 and C.A. No. 426 of 2008

In Re: Sintex Industries Ltd.

Date of Decision : 04-03-2009

Acts Referred:

Companies Act, 1913 — Section 17(2), 18, 86
Companies Act, 1956 — Section 100, 101, 102, 103, 180

Citation : (2011) 105 SCL 572

Hon'ble Judges : K.M. Thaker, J

Bench : Single Bench

Advocate : Thakore and Singhi, for the Appellant; Harin P. Raval, for the Respondent

Final Decision : Allowed

Judgement

K.M. Thaker, J.—Present petition has been taken out u/s 391(1) and (2) of the Companies Act, 1956 ("1956 Act") seeking below mentioned relief:

18(a) That this Hon'ble Court be pleased to sanction the Scheme of Arrangement being Annexure-C to the petition and declare the same to be binding on the Petitioner company and the equity shareholders of the Petitioner company and all persons concerned under the scheme;

2. Thus, the Petitioner seeks sanction for the scheme of arrangement ("the Scheme" for short) which is at Annexure-C and a declaration that the said scheme, upon sanction, shall be binding to all concerned persons.

Matrix of facts

3. Earlier, an application being Company Application No. 426 of 2008 was taken out by this Petitioner with a prayer for direction to convene the meetings. In the said Company Application No. 426 of 2008, this Court passed an order dated 29-7-2008 directing the Petitioner to convene the meetings of equity shareholders in accordance with the direction enumerated in the said order however the meeting of secured creditors, at the request of Petitioner, was dispensed with. Subsequently, by an order dated 4-2-2008, the said application

was disposed off. The below mentioned observations in the above referred order dated 29-7-2008 in Company Application No. 426 of 2008 are, for the purpose of present proceedings, relevant:

6. Mr. Thakore submitted that there would be reduction of Securities Premium Account which shall be affected as an integral part of the Scheme itself by way of a composite order from this Court. Mr. Thakore has further submitted that the Equity Shareholders of the applicant company are to consider the Scheme in the meeting which includes the said reduction. As the procedure u/s 101 read with Section 78 of the Companies Act, 1956 being *pari materia* with the present proceedings, no separate procedure for reduction of Securities Premium Account is required to be followed. Mr. Thakore has referred to Sections 100 and 101 of the Companies Act, 1956 and submitted that reduction contemplated in the Scheme does not involve either diminution of liability in respect of unpaid share capital or payment to the Shareholders of paid up share capital and does not in any manner affect the interest of creditors and no meeting of creditors is required. Mr. Mihir Thakore has relied upon the order dated 31-1-2003 passed by this Court in Company Application No. 30 of 2003 wherein this Court has dispensed with the following of a separate procedure for reduction of capital.

7. Upon hearing the submissions of Mr. Thakore and upon considering the judgment and order cited by him, I am of the view that the meeting of the creditors for considering the aforesaid scheme which includes reduction is not required. I hold that no separate procedure is required to be followed for reduction of Securities Premium Account, as the same is part and parcel of the said Scheme of Arrangement.

(Emphasis supplied)

4. It is claimed by the Petitioner that the meeting of the equity shareholders which was convened on 15-9-2008 was attended, either in person or by proxy or through authorized representative, by 96 equity shareholders possessing an aggregate of 6, 21, 14, 766 shareholding.

5. The question submitted to the said meeting was whether the equity shareholders of the company approve the arrangement embodied in the scheme submitted to the meeting. The question was submitted to the meeting in form of resolution and then the resolution was put to vote. It is claimed that 99 poll papers were distributed to 96 equity shareholders. After the voting process was concluded, papers of 7 equity shareholders holding 34,82,304 equity shares were not found in the ballot box instead 5 sheets of papers were found in the ballot box showing the votes in favour of the scheme. Poll papers of 1 equity shareholder holding 7,46,455 equity shares was declared invalid as on the poll paper a remark was put to the effect "abstain from voting". The remaining 88 equity shareholders, holding 5,78,86,007 equity shares voted in favour of the scheme. Thus, the scheme was approved. The said result of the meeting was reported to the Court by the Chairman, vide his report dated 19-9-2008.

6. It deserves to be mentioned that the Petitioner company, which is mainly engaged into the plastic business and textile business, has in the year 2006-07, acquired 74 per cent stake in Zeppelin Mobile Systems India Limited, in India and in 2007-08 the Petitioner company has acquired 81 per cent stake in Wausaukee Composite Inc., in USA and 100 per cent of Nero Plastic Inc., by Wausaukee Composite Inc., for consolidating its position in US plastic composite market. Thereafter, the Petitioner company also acquired Nief Plastic SA in France.

7. In this background of development and acquisitions, the Petitioner company mooted the scheme so as to undertake financial restructuring exercise whereby the Petitioner company proposes to create "International Business Development Reserve" by appropriating Rs. 200 crore from its "Security Premium Account" as on 31-3-2008.

8. The case of the Petitioner company is that the scheme does not involve either diminution of liability in respect of unpaid share capital or payment to any shareholder of paid up share capital and does not affect, in any manner, interests of creditors. It is also the case of the Petitioner company that there shall be reduction of the securities premium account but it shall be effected as an integral part of the scheme itself in accordance with the provisions of Section 78 and Sections 100, 102 and 103 of the Act.

9. In this backdrop, the Petitioner has presented this petition u/s 391 of the Companies Act, 1956 seeking sanction of the scheme and declaration as prayed for.

10. Upon presentation of the petition, order dated 23-9-2008 admitting the petition (for sanctioning the scheme approved in the meeting) was passed. By the said order, the Court directed the applicant/Petitioner to issue advertisement regarding the admission of the petition and also to effect the service of the notice to the Central Government.

11. Thereafter, an affidavit dated 29-9-2008 has been filed by one Mr. L.M. Rathod, CEO, declaring on oath that pursuant to the order dated 23-9-2008, advertisement was published in Indian Express and Sandesh on 26-9-2008 and has also produced copy of the advertisement along with an affidavit and also declaring that the notice of hearing of the petition has been served upon the Regional Director on 25-9-2008.

Submissions

12. Mr. Thakore, learned Senior Advocate with Mr. Singhi for Petitioner submitted that the meeting of equity shareholders has approved the scheme with overwhelming majority, rather unanimously, and the scheme is in overall interest of the Company and at the same time it will not adversely affect anyone's interest, including interests of creditors, in any manner. He further submitted that the scheme does not involve any action which is or would be contrary to any provision of any law and while framing and presenting the scheme all conditions

and requirements have been complied with. He submitted that the scheme deserve the sanction by this Court.

13. Mr. H.P. Raval, learned Assistant Solicitor General of India has appeared on behalf of the Central Government/Regional Director and has filed affidavit dated 8-12-2008 of the Registrar of Companies. By the said affidavit, the Deputy Registrar of Companies has placed on record, inter alia, that as per the Petitioner's balance sheet dated 31-3-2008, the Petitioner company has granted loan to M/s. BVM Finance Private Limited, a private company. It is further claimed in the affidavit that two directors of the Petitioner company are interested in the said other company and that the said loan was granted without previous approval of the Central Government. It is also stated that the Petitioner company has paid brokerage to Mr. Shyam Sundar Dangayach to the tune of Rs. 1 lakh without previous approval by the Central Government. The Deputy Registrar of Companies has also claimed that the said facts are material facts for considering and deciding the petition.

14. No rejoinder controverting the averments in the said affidavit has been filed by the Petitioner company. However, during the submissions it has been urged that the company has submitted its provisional reply dated 12-11-2008 with reference to the said allegations.

15. Mr. Thakore, on demur submitted that assuming occurrence of alleged breach, the consequences for such breach would independently ensue and the allegations will have to be tried and established, however, it would not have any bearing on the scheme.

16. In furtherance of the said affidavit, Mr. Raval submitted that the actions of the Petitioner company (extending loan to a private company in which its two directors are interested) constitute contravention of provisions u/s 295 of the 1956 Act and that therefore, in view of provision u/s 283(1)(h) of the 1956 Act the office of Directors had fallen vacant and consequently the resolution proposing the scheme could not have been mooted and passed by the Board and it could not have been placed for consideration and acceptance by the shareholders. He also submitted that the said action of the Petitioner (of paying brokerage) amounts to contravention of Section 297(1) of the Act.

17. Mr. Thakore has also placed reliance on provision u/s 290 and submitted that in any case the alleged actions are protected by said provision. The counsel for the Petitioner company has, in rejoinder, also orally claimed that it has forwarded a provisional reply to the allegations by Central Government vide its communication dated 17-10-2008. A copy of the said reply dated 12-11-2008 is placed on record. With reference to the allegation regarding the alleged loan, the Petitioner company has submitted thus:

1. The Company has paid advanced towards subscription of equity shares to BVM Finance Pvt. Ltd. (BFPL) during the financial year 2007-08 aggregating to amount Rs. 869 lakhs. The company has already complied the provision of

Section 372 A of the Companies Act, 1956 and it is within limit. The said amount has also been reflected in the Balance Sheet as at 31-3-2008 of BVM Finance Pvt. Ltd., under the head of "share Application Money (Pending Allotment).

Relevant provisions

18. In view of the rival submissions of the contesting parties, it is necessary to consider the submissions and facts of this case in light of the provisions contained under Sections 283(1)(h), 283(2), 290, 295 and 297 of the Act:

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

(a) to (g)** ** * (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;

(2) Notwithstanding anything in Clauses (d), (e) and (j) of Sub-section (1), the disqualification referred to in those clauses shall not take effect-

(a) for thirty days from the date of the adjudication, sentence or order;

(b) where any appeal or petition is preferred within the thirty days aforesaid against the adjudication, sentence or conviction resulting in the sentence, or order until the expiry of seven days from the date on which such appeal or petition is disposed of; or

(c) where within the seven days aforesaid, any further appeal or petition is preferred in respect of the adjudication, sentence, conviction, or order, and the appeal or petition, if allowed, would result in the removal of the disqualification, until such further appeal or petition is disposed of.

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.

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) and (e)** ** ** (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 a 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.
- (3)** ** ** (4) Every person who is knowingly a party to any contravention of Sub-section (1) or (3), including in particular any person to whom the loan is made or who has taken the loan in respect of which the guarantee is given or the security is provided, shall be punishable either with fine which may extend to five thousand rupees or with simple imprisonment for a term which may extend to six months;
- (5) and (6)** ** ** 297. Board's sanction to be required for certain contracts in which particular directors are interested.-(1) Except with the consent of the board of directors of a company, a director of the company or his relative, a firm in which such a director or relative is a partner, any other partner in such a firm, or a private company of which the director is a member or director, shall not enter into any contract with the company-
 - (a) for the sale, purchase or supply of any goods, materials or services; or
 - (b) after the commencement of this Act, for underwriting the subscription of any shares in, or debentures of, the company:

(Provided that in the case of a company having a paid-up share capital of not less than rupees one crore, no such contract shall be entered into except with the previous approval of the Central Government).
- (2) Nothing contained in Clause (a) of Sub-section (1) shall affect-
 - (a) the purchaser of goods and materials from the company, or the sale of goods and materials to the company, by any director, relative, firm, partner or private company as aforesaid for cash at prevailing market prices; or
 - (b) any contract or contracts between the company on one side and any such director, relative, firm, partner or private company on the other for sale, purchase or supply of any goods, materials and services in which either the company or the director, relative, firm, partner or private company, as the case may be, regularly trades or does business:

Provided that such contract or contracts do not relate to goods and materials the value of which, or services the cost of which, exceeds five thousand rupees in the aggregate in any year comprised in the period of the contract or contracts; or

(c) in the case of a banking or insurance company any transaction in the ordinary course of business of such company with any director, relative, firm, partner or private company as aforesaid, for the sale, purchase or supply of any goods, materials or services in which either the company, or the director, firm, partner or private company, as the case may be, regularly trades or does business, provided that the value of such goods and materials and the cost of such services do not exceed five thousand rupees in the aggregate in any calendar year comprised in the period of the contract or contracts.

(3) and (4)** ** ** (5) If consent is not accorded to any contract under this section anything done in pursuance of the contract shall be voidable at the option of the Board.

(6) Nothing in this section shall apply to any case where the consent has been accorded to the contract before the commencement of the Companies (Amendment) Act, 1960.

19. By virtue of the scheme, which is at Annexure-C (Pages 8 to 23) of petition which has been accepted and approved by the shareholders in the meeting on 15-9-2008, the Petitioner company proposes to undertake financial restructuring so as to create "International Business Development Reserve" by appropriating Rs. 200 crores from its Securities Premium Account obtaining as on 31-3-2008. Thus, the securities premium account shall, in the event of scheme being sanctioned, stand reduced or diminished by Rs. 200 crores. The said International Business Development Reserve is proposed to be utilized by the Petitioner towards expenses described in the scheme. The resultant effect and consequence of the scheme, if sanctioned by this Court, as evident from the salient features, would be as under:

5.1 Upon the scheme being effective and with effect from the Appointed Date, the securities premium account of SIL without any further act instrument or deed shall stand re-organized to the extent that on and from the Appointed Date. Rupees 200 crores shall be credited to the International Business Development Reserve Account from the securities premium account as appearing in Financials of the SIL as on 31-3-2008. International Business Development Reserve Account so created would be available towards the Expenses incurred by SIL until the balance is available in such account.

5.2 Upon the coming into effect of this scheme, the amount credited to the International Business Development Reserve Account as mentioned in Clause 5.1 above, shall be utilized by SIL to adjust the expenses.

5.3 To the extent of Securities Premium Account is credited to the International Business Development Reserve Account as mentioned in clauses 5.1 and 5.2

above and its subsequent utilization at an appropriate time as mentioned above, there shall be reduction of the securities premium account which shall be effected as an integral part of the scheme itself in accordance with the provisions of Section 78 and Sections 100, 102 and 103 of the Act as the same does not involve either diminution of liability in respect of unpaid share capital or payment to any shareholder of paid-up share capital and the order of the High Court sanctioning the scheme, shall be deemed to be an order u/s 102 of the Act confirming reduction of Securities Premium Account. The provisions of Section 101 of the Act will not be applicable.

5.4 Notwithstanding the reduction as mentioned above. SIL shall not be required to add "and reduce" as a suffix to its name and SIL shall continue in its existing name.

20. In view of the consequence of reduction of Securities Premium Account, the procedure as prescribed u/s 78 and Sections 101 to 103 of the Act was required to be followed, however considering the fact that the said procedure would be *pari materia* with the procedure being followed for the sanction of the scheme u/s 391, the procedure contemplated under Sections 78 and 101 was, by the aforesaid order dated 29-7-2008, dispensed with because the procedure u/s 391 was, even otherwise, being followed.

21. The shareholders have, as noticed earlier, during meeting held on 15-9-2008, accepted and approved, by a majority in number representing 3/4th in value of holding, the proposed scheme. The result and outcome of the voting has been reported by the Chairman vide its report dated 19-9-2008.

22. If the result/outcome of the meeting is taken into account by considering the details mentioned at (b) and (c) of the Chairman's report, then the statutory requirement u/s 391 regarding acceptance and approval by the shareholders is met with and fulfilled.

23. It deserves to be mentioned that in his affidavit/objection filed by the Dy. Registrar, no objection regarding the meeting and/or the procedure of the meeting and/or the outcome of the voting has been raised and he has also not raised any objection to the effect or on the ground that the statutory requirement, i.e., the condition precedent for considering the scheme as accepted and approved by the shareholders has not been met with and fulfilled.

24. Thus, this Court has to proceed on the premise that the proposed scheme has been accepted and approved by the shareholders in accordance with the procedure prescribed by the Act.

25. When the statutory majority of the shareholders have, after detailed and careful consideration and deliberations over the scheme, accepted and approved the same, this Court would ordinarily not sit in appeal over the commercial wisdom of the company, its Board of Directors and its shareholders.

26. However, at the same time, the Court would also not act as a mere rubber

stamp and would not proceed to grant sanction mechanically and without examining the relevant aspects and without being satisfied about the compliance with statutory requirements. It is Court's obligation to ascertain as to whether the scheme would be, generally, in the interest of the company and the shareholders and/or the creditors or not and whether there is anything in the scheme which is objectionable or contrary to or in violation of any other provisions of the 1956 Act. It is, in view of and part of such obligation that objections of the Central Government are invited.

27. It is pertinent that the Central Government, through Dy. Registrar of Companies, has also not raised any objection as regards the provisions of the scheme or merits of the scheme and has, as noticed earlier, not raised any other objections except the two objections i.e., the two irregularities, mentioned in the affidavit.

28. The purport of the objection by the Central Government is that at the material point of time i.e., when the Board of Directors passed the resolution the office of the Directors had, in view of the infraction of the provision contained u/s 295, fallen vacant and that therefore, the Board of Directors could not have mooted the scheme and/or passed the resolution.

29. Differently put the crux of the submission is that the resolution cannot be said to be valid as it has not been passed properly and therefore all subsequent actions also are invalid.

30. So as to consider the said submission it is necessary to first take into account the relevant provisions. Section 283(1)(h), inter alia, provides that the office of a director shall become vacant if the director, 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 of 1956 Act.

31. Thus, comes in picture Section 295 of the 1956 Act.

32. Section 295, inter alia, provides that no 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.

33. On the premise that as per Balance Sheet dated 31-3-2008 the Petitioner company has given loan to a private limited company named BVM Finance Pvt. Ltd. in which two directors viz. Mr. Dinesh B. Patel and Mr. Anuprasad P. Patel of Petitioner company are interested (being directors in that other company) and that the loan has been made without previous approval of Central Government, it

is claimed that the action violates Section 295 and resultantly in view of Section 283(1)(h) the office of the two directors in Petitioner company had fallen vacant and such vacancy had automatically i.e., by virtue of operation of law, occurred at the time when the loan was made/given.

34. This contention is, then, taken further to its logical end and it is submitted that the Board which passed the subject resolution consisted the said two directors as well; whereas in view of Section 283(1)(h) they had ceased to hold the office and their office had fallen vacant and thus the resolution cannot be said to have been validly passed and that would render the subsequent actions invalid.

35. There is merits and justification in the said submissions of Mr. Raval inasmuch as if it is duly established that the loan, as is being claimed by Central Government, has been given; then the office of the said two directors would, by operation of law, but subject to other provisions stand vacant from the date on which such loan was given. The question which would, however, arise is as to whether the said vacancy in the office of two directors render the resolution and subsequent actions, invalid.

36. Obvious it is that such violations, if duly established, would entail consequences in accordance with the provisions of the Act.

37. However, according to the Petitioner company it has, in such circumstances a protective umbrella in form of provision u/s 290 and it can take shelter under the said provision.

38. Anticipating such submissions, learned Assistant Solicitor General, as mentioned earlier, pre-empted the Petitioner company's submission on the premise of Section 290 of the 1956 Act and he submitted that the Petitioner company, so as to counter the submission on the basis of alleged breach of Sections 295 and/or 297(1) of the 1956 Act, would depend upon the provisions u/s 290 of the 1956 Act, however, the said defence would not be available to the Petitioner company/directors inasmuch as the defence on the basis of the said Section 290 of the 1956 Act would be available to third party or an outsider.

39. Mr. Thakore referred to the provisions u/s 290 and more particularly, the proviso of the said section and submitted that even if the contention on behalf of the Central Government is to be accepted then also only those actions which might have been taken after the Board was/ Directors were shown that the appointment of two directors had become invalid, would be rendered void and not other i.e., not those actions which might have been taken before it was shown that the appointment had been rendered invalid resulting in vacancy in office. In furtherance of the said submission, Mr. Thakore submitted that the company/directors have been shown, for the first time that the appointment of two directors had become invalid by communication dated 17-10-2008 i.e., after the notice issued by this Court to the Central Government/Regional Director calling for explanation. He submitted that the said letter dated 17-10-2008 was

replied by the company on 12-11-2008. He submitted that all the actions i.e., the action of passing the resolution and mooting the scheme and/or the same getting accepted by the shareholders in the meeting on 15-9-2008, have taken place much prior to the communications dated 17-10-2008 and thus, the same cannot be treated as invalid.

40. On plain reading of the said provision the submission on behalf of the Petitioner company does not appear to be on strong platform. In view of the language and object of the said provision, the said provision will not be applicable and cannot be invoked and that too, by the directors, to defend an action which was, when taken, prohibited by or contrary to law or in violation of other provisions.

41. The object and scope of the provision appear to be to provide protection to those who, unaware of rules or restrictions of indoor management of a company and/or about the authority of an individual (e.g, director or employee of the company) enter into a transaction, but such protection will not be available to, and the provision cannot be invoked by, directors or company to salvage unauthorized act.

42. In this regard reference of the below mentioned judgments, is made:

- (i) Mohan Lal and Another Vs. Grain Chamber Ltd., Muzaffarnagar and Others,
- (ii) Vivek Kumar v. Pearl Cycle Industries Ltd (In Liquidation) [1983] 54 Comp. Cas. 77 Del,
- (iii) Eastern Linkers Pvt. Ltd. Vs. Dina Nath Sodhi,
- (iv) Col Kuldeep Singh Dhillon v. Paragaon Utility Financiers (P.) Ltd. [1988] 64 Comp. Cas. 19 (P&H).

43. So far as the judgment of the Hon"ble Apex Court in the case of Seth Mohan Lal (supra) is concerned, Mr. Raval refer to and relied upon Paragraph 15 of the said judgment which reads thus:

15. Regulation 94 of Table A in the First Schedule is not one of the obligatory regulations which is to be deemed by Section 17(2) of the Indian Companies Act, 1913 to be incorporated in the Articles of Association. Section 18 provides:

"In the case of a company limited by shares and registered after the commencement of this Act if articles are not registered, or, if articles are registered, insofar as the articles do not exclude or modify the regulations in Table A in the First Schedule those regulations shall, so far as applicable, be the regulations of the company in the same manner and to the same extent as if they were contained in duly registered articles."

The Respondent company is limited by shares and was registered after the commencement of the Indian Companies Act, 1913; the Company has adopted special Articles of Association, but there is no Article which excludes or modifies.

Regulation 94 of Table A, and by the operation of Section 18 of the Act that Regulation must be deemed to apply in the same manner and to the same extent as if it was contained in the registered articles of the Company. We are unable to hold that because the Company has not incorporated Regulation 94 of Table A in its Articles of Association, an intention to exclude the applicability of the regulation to the Company may be inferred. Regulation 94 of Table A is not expressly excluded by the Articles of the Company: that is common ground. It is not excluded by implication: for it is not inconsistent with any other express provision in the Memorandum of the Articles of Association. 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 necessary to decide whether Section 86 of the Indian Companies Act, 1913 also grants protection to the acts done by directors who are subsequently discovered to be disqualified.

44. The Hon^{ble} Delhi High Court has, in the judgment of Eastern Linkers (P.) Ltd. 's case (supra) observed thus:

As the said allotment was made by a director who was purported to have been elected at an invalid meeting, the said action lacked in validity. Mr. Talwar, however, sought to invoke Section 290 of the Companies Act to say that any act done by or purported to be done by a director is valid notwithstanding that it may afterwards be discovered that his appointment was invalid by any reason of defeat or disqualification. The argument is that it is only subsequently during the present proceedings that it has been found that the meeting of April, 1970 which elected Mrs. Bali as director was invalid, and, therefore, the act of Mrs. Bali as a director allotting these shares must be held to be valid in terms of this section. We cannot agree. Now, Section 290 is based on the rule culled out from *Turquand's* case [1956] 25 LJ QAB 317; 6 E&B 327, which, as reproduced in *Morris v. Kanseen* [1946] 16 Comp.Cas. 186; [1946] 1 All ER Rep. 586; [1946] AC 459 (HL), is to the effect that "persons contracting with a company and dealing in good faith may assume that acts done within its constitution and powers have been properly and duly performed, and are not bound to inquire

whether acts of internal management have been regular". But this rule is not applicable to the present case. The reason is that this section which is equivalent to Section 143 of the English Companies Act, 1929, and Section 180 of the Companies Act, 1948 cannot apply to a transaction where a director or a de facto director invokes the rule so as to validate a transaction which was in fact irregular and unauthorized. The jurisdiction for this rule is that normally the wheels of business will not go smoothly unless it may be assumed that all is in order which appears to be in order. But the maxim has its proper limits as explained in Morris' case [1946] 16 Comp. Cas. 186; [1946] 1 AER 586 (HL), that it is a rule designed for the protection of those who are entitled to assume, just because they cannot know that the person with whom they deal has the authority which he claims.

(Emphasis supplied)

45. Mr. Raval also relied upon of the observations made by the Hon"ble Punjab & Haryana High Court in the judgment of Col. Kuldip Singh Dhillon's case (supra). The observations on which Mr. Raval placed reliance reads thus:

It is true that the resolution, exhibits P-1, P-17 and P-18, were also held invalid on the ground, that the quorum for the meeting was incomplete as some of the directors present there ceased to be so. But, in the facts and circumstances of this case, the section does not give protection to the resolutions passed in such meetings. The reason is that the resolutions in the present case have not been passed bona fide by the directors, as out of the six beneficiaries, five were directors of the company and the sixth was the wife of one of them. The sole object of the directors in passing the resolution was to promote their self-interest. Moreover, the benefit of the said section can normally be taken by a third person and not by the directors or their close relations. It is further noteworthy that some of the resolutions were oppressive to the minority shareholders. In *Sunder Lal Jain Vs. Sandeep Paper Mills P. Ltd. and Others*, it was observed by me that even if a director ceased to be so in view of Section 283, the resolution of the board of directors could not be held illegal in view of Section 290 which provided that the acts done by a person would be valid notwithstanding that it might 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 the Act or in the articles. The facts of that case were that a boiler was sold by the company after a decision had been taken in a meeting of the board of directors. The purchaser had no concern with the company. He took a plea that he was a bona fide purchaser for valuable consideration. The case is clearly distinguishable and, therefore, the observations therein are of no help in deciding the petition.

(Emphasis supplied)

46. The said judgments support and fortify the view that the protection will not be available to and the provision cannot be invoked by directors and company to

shield or salvage unauthorized act.

47. In view of the aforesaid submissions by the Central Government on the basis of the provision u/s 290 of the 1956 Act, it has been alternatively submitted on behalf of the Petitioner company that the Board of Directors of the Petitioner company comprise 11 directors including the aforesaid two directors Mr. D.B. Patel (Chairman) and Mr. A.P. Patel (Vice-Chairman).

48. It is further submitted that the resolution mooted the subject scheme and resolving to place it for consideration, acceptance and approval by the shareholders and thereafter for sanction by the Court, was moved under and in accordance with Article 170 of the articles of association by way of a circular resolution and the said resolution was passed by circulation. In light of the said factual aspect it is further submitted that the resolution was passed unanimously and the same has been signed by all 11 directors.

49. In support of the said submission, copy of the circular resolution has been placed on record and a copy thereof has also been supplied to Mr. Raval, learned Assistant Solicitor General appearing for the Central Government.

50. From the copy of the said circular resolution, it transpires that all 11 directors have signed the said resolution. No objection or any contention on this count has been raised by or on behalf of the Central Government.

51. In light of the said factual aspect, it has been submitted by Mr. Thakore Senior Counsel, on behalf of the company, on demurer and without prejudice to other contentions, that even if it is assumed for the sake of argument that office of the two directors can be said to have fallen vacant in light of the provisions u/s 283(1)(h), read with Section 295, of 1956 Act, then also, the passing of the resolution by the Board of Directors is legal and valid since it has been signed by all directors and the signature of and approval by the other 9 directors would save it from being rendered invalid.

52. Mr. Thakore, Senior Advocate on behalf of the Petitioner company submitted that in the Petitioner company, it being a public limited company, the minimum requirement of number of directors would be 3 whereas, the company's Board comprises 11 directors and all of them have signed the circular resolution. Thus, even if the office of the two directors is assumed to have fallen vacant when the resolution was passed, then also the said resolution and the subsequent actions do not become invalid.

53. It is the case of the Petitioner company that the Articles of Association permit passing of resolution by circular. The applicant company has placed reliance, for substantiating the aforesaid submission, on Article 170 of Articles of Association. The said Article reads thus,

170. Resolution by circular.-A written resolution circulated to all the Directors or members of committees of the Board, whether in India or overseas and signed by a majority of them as approved, shall (subject to compliance with the relevant

requirements of the Act) be as valid and effective as a resolution duly passed at a meeting of the Board or committee of the Board, called and held in accordance with these Articles provided that it has been circulated in draft form, together with the relevant papers, if any to all the Directors.

54. It can be seen from the said provision that a resolution passed by circular, by virtue of the said provision, has effect of a resolution passed at a meeting of the Board. Further, the said Article also provides that the resolution by circular shall stand and deemed to have been passed if the same is signed "by a majority of them as approved." Hence, if majority of the Directors sign the resolution then the same is deemed to have been passed.

55. In present case, the resolution is said to have been passed unanimously i.e., by all 11 Directors. A copy of the resolution placed on record substantiates the said submission inasmuch as all 11 Directors have signed the said resolution. There is no dispute about the fact that (a) the resolution recording the scheme was moved by way of "circular resolution" in accordance with the provisions under Article 170 of the Articles of Association of the company; (b) the Board of Directors of the company comprise 11 directors and that all of them have signed the resolution; (c) the fact that the resolution has been passed in accordance with relevant provisions of Articles of Association and the relevant provisions of the Act.

56. Now, therefore, even if the vote/signature of the concerned two Directors is to be overlooked and ignored then also the resolution would bear signatures of 9 Directors and thus, it can be said that the same was duly passed in accordance with Article 170 of the Articles of Association. Consequently, the alleged disqualification of the two Directors of the company would not, in light of the aforesaid peculiar facts of this case, render the resolution invalid and the resolution is, thus, salvaged.

57. Under the circumstances, in present case, it is not necessary to examine the contention of the Central Government raised on the ground of breach of Section 295 and the effect in light of provisions of Section 283(1)(h) of the 1956 Act inasmuch as even if it is assumed that the office of two directors had fallen vacant, then also the fact that the resolution has been passed by majority of the Directors in accordance with Article 170 of the Articles of Association, the alleged vacancy in the Board of Directors would not, at this stage and for the limited purpose of considering the scheme, have any bearing or relevance.

58. As an upshot of the aforesaid discussion, it has to be held, in facts of present case that the resolution can be said to have been validly passed and it is not invalid and that therefore, the subsequent actions viz., the presentation of the scheme for the acceptance and approval by the shareholders and the decision of the majority shareholders to accept and approve the scheme, also cannot be said to be invalid.

59. Resultantly, this Court has to accept that the majority of the shareholders

has accepted and approved the scheme.

60. This leaves behind the objection based on the alleged breach of Section 297(1). As a second limb of the objection it is further submitted by Assistant Solicitor General that the Petitioner company has paid brokerage to M/s. Shyam Sunder Dangayach without previous approval of the Central Government and that the provision u/s 297(1) of 1956 Act is, thereby, violated.

61. The said Section 297, inter alia, provides that, except with the consent of the Board of directors of a company, a director of the company or his relative, or a private company of which the director is a member or director, shall not enter into any contract with the company-(a) for the sale, purchase or supply of any goods, materials or services; or (b) after the commencement of this Act, for underwriting the subscription of any shares in, or debentures of the company.

62. The Petitioner company has given a provisional reply, to the said allegation, in following terms (by its letter dated 12-11-2008):

2. In respect of brokerage paid to Mr. Shyam Sunder Dangayach, we would like to state that during the financial year 2006-07, the Company has paid brokerage to Mr. Shyam Sunder Dangayach, amounting to Rs. 0.75 lakh for sourcing material and arranging transfer of DEPLB import licence, which is very negligible amount looking to the turnover and size of the Company. Further, the said payments have been made at prices, which are reasonable having regard to the prevailing market prices at the relevant time. Further during the financial year 2007-08, there was no transaction in this regard.

We are in the process of preparing the compounding application, since it will take some time to prepare, get signature of Directors and to get ready all documents our matter of Scheme of Arrangement will be delayed. You are requested to approve our case, we will file the compounding application and will submit the acknowledged copy of the same with your office.

63. The said reply and even the nature of allegation do not leave any room for doubt and make it clear that the allegation, in the first instance, will have to be proved so as to establish the alleged breach of Section 297(1). If it is duly established that the Petitioner company paid any brokerage to Mr. Dangayach without previous approval of Central Government, then, in view of proviso of Sub-section (1) of Section 297, such action would amount to and constitute violation of Sub-section (1) of Section 297.

64. The next question which would arise, however, if that assuming that the breach of Section 297(1) is proved, will it, in any way, have bearing on the decision to grant or to refuse to grant sanction to the scheme? In other words, whether in view of such breach the Court should refuse to sanction the scheme.

65. In this regard, reference can be made to the judgment of the Hon'ble Bombay High Court in the case of Zenith Electro-Systems (P.) Ltd., In re [1990] 69 Comp. Cas. 138 wherein the Hon'ble Bombay High Court, while considering

the alleged violation of Section 372(2), held as follows:

Moreover, for violation of Section 372, a remedy is provided u/s 374. It imposes a fine of Rs. 5,000 on the company and every officer of the company in default. In case the Central Government desires to take any steps against the transferee-company for this alleged violation of Section 372, it has a remedy at law which is not affected in any way by virtue of this amalgamation. Because the transferee-company will continue to exist, steps can, therefore, be taken against the transferee-company if so required.

The alleged violation of Section 372(2), therefore, does not stand in the way of the amalgamation scheme. In any case, the transferee-company at present is not violating Section 372(2) as this section is no longer applicable to the transferee-company. There is no provision under the Companies Act which prevents the present amalgamation scheme.

66. In this regard reference can also be made of the judgment in the case of *In Re: Gwalior Strips Ltd.*, and the judgment in the case of *Cetex Petrochemicals Ltd.*, *In re* [1992] 73 Comp. Cas. 298 (Mad.). In case of *Gwalior Strips Ltd.* (supra) the Hon"ble Madhya Pradesh High Court has observed:

In my view, the pith and substance of law bearing on amalgamation of companies, as pointed out in the case of *Saraswati Industrial Syndicate* [1990] 70 Comp. Cas. 184, is that the scheme proposed may be sanctioned in such terms as the Court may decide and the amalgamation may be made effective under the order from such date or subject to such contingency as may be specified but in all cases the discretionary jurisdiction is to be exercised reasonably in the best interest of the corporate entities to fulfil the object of the proposed scheme. When merger between them takes place, the transferor company ceases to exist and carry on business in *In Re: Cetex Petrochemicals Ltd.*, the view taken is that the Court should be normally satisfied in respect of the requirements statutorily contemplated such as of the resolution being passed by a statutory majority in accordance with Section 391 (2) of the Act; in the exercise of its discretion in sanctioning the scheme, the Court is to be satisfied that the scheme, as a whole, having regard to the general conditions and background and object of the scheme is a reasonable one though it is not for the Court to interfere with the collective wisdom of the shareholders of the company.

67. Mr. Thakore has, in this context, also relied upon the judgment of this Court in the matter between *Surbhi Chemicals and Investment Limited* in Company Petition No. 131 of 2008 and order of this Court dated 23-10-2008 in the matter of *Cadila Healthcare Limited* in Company Petition No. 243 of 2008.

68. In light of the position settled by the aforesaid judgments and upon considering the relevant provisions of the Act as well as the scheme and also after considering the following aspects; that:

(a) the consequences/penalty for such breach is separately provided in the act;

and that

(b) there is, on one hand no direct nexus between the provisions of the scheme and the provisions under which sanction is sought for and on the other hand the provisions which are allegedly violated; and that

(c) the conditions precedent and other requirements regarding sanction are separately provided (e.g., Section 78, Section 100, Section 101, Section 391 etc.) and the said provisions do not envisage such restriction or consequence; and that

(d) it is not the claim that the preconditions or the requirements and the procedure required to be complied with for seeking sanction have been violated (Central Government or any other authority or creditors/shareholders have not claimed any breach of the relevant provisions) and they are deemed to have been complied (in view of the waiver/dispensation allowed by the order dated 29-7-2008 coupled with compliance of procedure u/s 391) with; and

(e) it is also not claimed by any one, including Central Government or the creditors or the shareholders, that the terms of the scheme are contrary to or violate any statutory provisions.

It does not appear necessary to allow the alleged breach, in the peculiar facts of the case, to affect or influence the decision regarding the scheme. However, some safeguard or appropriate condition to protect the concern, anxiety and the obligations of Central Government deserves to be prescribed and the issue as to whether the sanction should be granted or not ought to be considered and decided independently and by divorcing the issue of sanction from the issue of alleged breach of Section 297(1).

69. Once it is found that the resolution by the Board of Directors is valid and the alleged vacancy in the Board of Directors, would not invalidate the resolution, then as a corollary the subsequent actions-including the acceptance and approval of the scheme by majority of the shareholders- would also be valid and the consequences of alleged breach of Section 295, if and when established, would; of course, follow in accordance with the provisions of the act and the Court's decision qua the scheme will not affect, in any manner, the proceedings or result regarding alleged breach. Likewise, the alleged breach of Section 297(1) also, as discussed earlier, need not detain or dissuade the Court from deciding the prayer for the sanction of the scheme. In the aforesaid backdrop the Court has to decide the prayer for the sanction independently.

70. It can be seen from the scheme that the reduction of the "securities premium account" is to be effected as an integral part of the scheme and the "international business development reserve account" is going to be utilized by the Petitioner company to adjust the expenses and the said account would be available towards the expenses until balance is available in such account. It is also noticed from the Chairman's report which is not opposed or doubted by any

one including Central Government-that the resolution is passed by statutory majority in accordance with Section 391(2) at a meeting duly held. Further, the majority's decision appears to have been taken without coercion and undue influence and the object as well as the terms of the scheme appear reasonable and have been so found by the shareholders in their collective and commercial wisdom and the scheme also does not appear to be (and no one-including the Central Government or the shareholders-has alleged it to be) against the interest of the company or shareholders. There does not appear to be any legal impediment in the scheme and 3/4th majority of the shareholders in share value has accepted and approved the scheme and thereby the reduction in the "securities premium account." This Court would not sit in appeal over the decision of shareholders and will not doubt their commercial wisdom. Besides, the conditions and requirements for submitting the scheme for sanction, have been fulfilled and no other objection, except the two objections raised by Central Government, has been raised. Further, as per the provisions of the scheme, as well as assertion and the declaration by the Petitioner company the said rearrangement is not going to adversely affect any creditors and it does not involve diminution of liability in respect of unpaid share capital or payment to shareholders of paid up share capital. On the anvil of the well-recognized criteria, the scheme does not appear to be unreasonable and except the two objections no other illegality or violation is brought to the Court's notice.

71. In view of this Court there is no valid and good ground to refuse to grant the sanction qua the scheme, which, however, is subject to the conditions prescribed by this judgment and order. It is declared that this Court's decision regarding the relief prayed for in the petition (i.e., sanction or refusal to sanction the scheme), will not have any bearing on and will not affect the future actions by the Respondent Central Government or any consequences which may ensue on account of any action of the company including the actions mentioned in the communication dated 17-10-2008 and/or 5-12-2008. The intimation dated 17-10-2008 and the subsequent communication dated 5-12-2008 would naturally be pursued and taken to its logical end in accordance with the provisions under the Act, by the Competent Authority. The scheme and/or the decision of the Court also would not give any impunity to the company or to the directors from any proceedings including prosecution and hence, the proceedings which might have been already initiated or which are likely to be initiated and may be initiated will not be effected in any manner.

72. It is, therefore, clarified and directed that the grant of sanction by or the observations of this Court in this case, shall not have any effect, in any manner whatsoever, over the future actions and/or proceedings and/or consequences which may take place or may be undertaken in view of or on account of alleged breach and/or pursuant to the said two notices and it would be open and permissible to the competent authority to take appropriate actions in accordance with the provisions of the Act with regard to the alleged irregularities mentioned in the affidavit and/or communications dated 17-10-2008 and 5-12-2008 and

present order sanctioning the scheme would not in any manner whatsoever dilute the proceedings and/or the action which the competent authority may consider appropriate to take with regard to the alleged irregularities, or the result therein and the same shall be considered and decided independently and without being influenced by this order.

73. In the result, with the aforesaid clarifications and subject to the aforesaid conditions and directions and also without prejudice to and while keeping open the rights of the Central Government/competent authority to pursue any action which it may consider appropriate and necessary in respect of the alleged breaches, the scheme of arrangement is sanctioned. The relief as prayed for in paragraph 18(a) of the petition is granted. The petition is, thus allowed and is disposed off accordingly, subject to the aforesaid conditions and to the aforesaid extent.

74. So far as the costs to be paid to the Central Government is concerned, the same is quantified at Rs. 3,500. The same may be directly paid to the learned Assistant Solicitor General Shri H.P. Raval appearing for the Central Government.