

(1966) 08 BOM CK 0011

In the Bombay High Court

Case No : A.F.O.D. No. 788 of 1965 with Writ Civil Application No. 2793 of 1965

J.S. Davar and Another

APPELLANT

Vs

Shankar Vishnu Marathe and Others

RESPONDENT

Date of Decision : 20-08-1966

Acts Referred:

Companies (Amendment) Act, 1956 — Section 391(2)
Companies Act, 1913 — Section 153(2)

Citation : AIR 1967 Bom 456 : (1967) 69 BOMLR 261

Hon'ble Judges : K.K. Desai, J;Chandrachud, J

Bench : Division Bench

Advocate : R. Mathelone and B.A. Desai, for the Appellant; Marzban Mistry and Y.S. Chitale, for the Respondent

Judgement

Chandrachud, J.

(1) This is an appeal by the Official Liquidators of a private limited company called "the Pioneer Dying House Limited" from the judgment of the learned District Judge Poona, sanctioning a scheme for reconstruction of the company. The facts leading to this appeal may be stated thus:

(2) In 1964, a partnership firm by the name of "Pioneer Dying House" was formed for the purpose of dyeing, printing and processing Calico cloth. It consisted of three partners D. B. Phatak, G. G. Ketkar and C. S. Phatak. On 1st of November , 1964, the firm was transformed into a Private Limited Company with an authorised capital of Rs. 5,00,000. D. B. Phatak was appointed a Managing Director of the company, while the two other partners, G. G. Ketkar and C. S. Phatak were appointed Directors. On the 10th of November 1952, a petition for winding up of the company was filed by two creditors of the company, Harihar Ramkrishna Karandikar and Anandibai Karandikar. On the 2nd of February 1954, D. B. Phatak presented a scheme for reconstruction of the company, but the attempt to revive the company was given up as the scheme could not be worked out. On the 13th of August 1954, the learned District Judge,

Poona, ordered the company to be wound up.

(3) The company had constructed a building called "Pioneer House" on the Laxmi Road,. Poona. D. B. Phatak, the Managing Director of the Company, made a claim that the building was of his private ownership and therefore, on the 6th of June 1955, the Official Liquidators filed Civil Suit No. 835 of 1955 against him and another person for a declaration that the building as well as the land under it were the ownership of the company. The trial Court held by its judgment, dated the 24th of July 1956, that the building belonged to the Company but the land under the building belonged to D. B. Phatak. The Official Liquidators did not challenge that part of the decree which was against the company but D. B. Phatak filed Appeal No. 537 of 1956 in the District Court, Poona, to challenge the correctness of the decision that the building belonged to the company. By his judgment, dated the 24th of April 1959, the learned Extra- Assistant Judge, Poona, dismissed the appeal and confirmed the decree of the trial Court. D. B. Phatak filed Second Appeal No. 925 of 1959 in this Court against the decree of the District Court, but that appeal was withdrawn during the hearing of this appeal.

(4) On the 2nd of November 1957, that is after the trial Court delivered its judgment in Suit No. 835 of 1955, the Official Liquidators filed a misfeasance summons against D. B. Phatak and others on the basis of the finding recorded by the trial Court that the Managing Director was guilty of fraud. That finding formed the subject-matter of the second appeal filed by the Managing Director in the High Court has as stated earlier, the appeal was withdrawn.

(5) On the 12th of September 1964, that is more than ten years after the winding up order was passed, an application was filed in the District Court, Poona, by five persons propounding a scheme u/s 158 of the Indian Companies Act, 1913, for the reconstruction of the company. Three of the five sponsors of the scheme are creditors of the company, while the two others Gopal Ganesh Ketkar and Achyut Dattatraya Phatak are the Directors of the company. Ketkar is a near relative of the Managing Director, while Achyut Dattatraya Phatak is the son of the Managing Director. Both of them are also said to be the creditors of the company.

(6) Stated briefly, the following proposals are contained in the scheme.

(a) That the leasehold rights in the vacant plot of about three acres at Yerandavana, belonging to the company be sold to two persons Lieutenant Colonel S. S. Pandit and K. D. Joshi for Rs. 1,85,000.

(b) That the value of the shares held by the shareholders of the company be reduced from Rs. 1,47,000 to Rs. 14,700.

(c) That the creditors of the company be paid a dividend of twenty-five paise from out of the sale proceeds of the vacant plot and from the amount of the rent of the "Pioneer House" (The Managing Director had agreed to sell the Pioneer

House, Laxmi Road, Poona, to a company called Yeshwant Mutual Insurance Company, Limited, taking an earnest of Rs. 47,000. The Insurance Company was put in possession of the building by the Managing Director who treated the property as his own. The Insurance Company did not want to enforce its rights under the agreement of sale and it was willing to pay to the Official Liquidators the sum of Rs. 19,000 and odd which was in its hands after the appropriation of Rs. 47,000 paid by it as earnest under the agreement of sale. The Official Liquidators had also in their hands a sum of about Rs. 24,000 from out of the rent of the "Pioneer House". Thus the amount available for distribution amongst the creditors of the company was about Rs. 43,000 in addition to the sale proceeds of the vacant plot, amounting to Rupees 1,85,000.)

(d) That the Company will issue debentures of the value of Rs. 2,02,500 to the depositors and other creditors of the company in partial satisfaction of the amount due to them. The debentures would be repayable at the end to ten years and the interest at 7 1/2 per cent per annum could, at the option of the Company, be capitalised during the first three years.

(e) That the creditors should forgo twenty-nine paise in a rupee in consideration of the interest paid by the company on the debentures.

(f) That D. B. Phatak, the Managing Director of the Company, will transfer the land under the building called "Pioneer House", Laxmi Road, Poona, to the company for a consideration of Rs. 47,000 which was already received by him from the Yeshwant Mutual Insurance Company Limited under an agreement of sale.

(g) That the company should take over the personal debts of D. B. Phatak amounting by adjustment to Rs. 1,57,000. A sum of Rupees 70,000 in cash was to be paid to the personal creditors of D. B. Phatak in partial satisfaction of the balance of Rs. 87,000, debentures of the value of Rs. 30,000 repayable within ten years and bearing interest at 7 1/2 per cent per annum were to be issued to those creditors. In respect of the amount of Rs. 57,000 which would still remain payable to Phatak's personal creditors, the company was to execute a mortgage in their favour for a period of five years bearing interest at 6 per cent per annum.

(7) On the 23rd of October 1964, the Official Liquidators filed their reply exhibit 389 to the proposed scheme. They protested against some of the proposals contained in the scheme as for example the proposal that the vacant plot at Yerandavana be sold by private treaty and contended that if all the assets of the company were sold, it would be possible to pay the creditors and the depositors, fully. In the last paragraph of their reply, however, the Official Liquidators stated that they would abide by the orders of the Court and their attitude was that they would neither oppose the scheme nor give their consent to it.

(8) On the same day that the Official Liquidators filed their reply, the learned District Judge directed that a meeting of the share-holders and the creditors of the company be held under the Chairmanship of an Advocate called V. R. Phadke

for ascertaining their wishes. The Chairman was directed by the District Judge to put before the meeting the views of the Liquidators. A separate meeting was directed to be held of the shareholders and the creditors of a company called the Maharashtra Textiles Limited to which the Pioneer Dying House Limited owed a debt of Rs. 1,20,000. The Maharashtra Textiles Limited were themselves in liquidation and Mr. J. S. Davar, who is one of the Official Liquidators of the Pioneer Dying House Limited, was appointed a Liquidator of the Maharashtra Textiles Limited also.

(9) The meetings of the shareholders and the creditors of the Pioneer Dying House Limited were held on the afternoon of the 13th of December 1964. The report exhibit 398, dated the 19th of January 1965, submitted by the Chairman, V. R. Phadke, to the District Court shows that all the nine shareholders of the Pioneer Dying House Limited consented to the scheme. The meeting of the depositors and the creditors, which was held separately from the meeting of the shareholders, was attended by 124 persons representing claims of the value of Rs. 4,38,004. 36 creditors appeared personally and 88 appeared through proxies 7 creditors representing claims of the value of Rs. 43, 345 opposed the scheme whereas others holding a total claim of Rs, 3,31,399 consented to the scheme. On the material date, the company held deposits of the value of Rupees 5,00,000 and the other debts amounted to Rs. 2,50,000.

(10) The meetings of the shareholders and the creditors of the Maharashtra Textiles Limited which was the largest single creditor of the Pioneer Dying House Limited, were held separately on the 19th of January 1965. The report of the Chairman at exhibit 248 shows that all the shareholders gave their consent to the scheme. In the meeting of the creditors, 13 creditors attended personally and 23 by proxies 35 creditors consented to the scheme, whereas one creditor opposed the scheme.

(11) The learned District Judge, Poona, has sanctioned the scheme by his judgment, dated the 29th July 1965. He observes that more than 75 per cent of the creditors and depositors of the company had consented to the scheme, that the bona fides of the sponsors of the scheme and of those creditors and depositors who consented to it were not disputed and that the scheme was conceived in the larger interest of the company. Being aggrieved by the judgment, the Official Liquidators have filed this appeal.

(12) The first question which arises in this appeal is whether the Court whose sanction is sought to a scheme of reconstruction is bound by the decision of the majority of the shareholders and the creditors of the Company or whether it is open to the Court to refuse to sanction a scheme despite the view of the majority. The answer to this question can, in our opinion, be found in section 153, of the Indian Companies Act, 1913, which governs the present proceedings. S. 153 provides by sub-section (1), in so far as is material that where a compromise or arrangement is proposed between a company and its creditors or its members, the Court may order that a meeting be held of the creditors or the

members of the Company. Sub-section (2) of section 153 which is to the point reads thus:

"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 either in person or by proxy at the meeting, agree to any compromise or arrangement, the compromise or arrangement shall, if sanctioned by the Court, be binding on all the creditors or the class of creditors, or on all the members or class of members, as the case may be, and also on the company, or in the case of a company in course of being wound up, on the liquidator and contributories of the company."

It is clear from the language of sub-section (2) that the Court is not bound to accept the view of the majority. Sub-section (2) says that if a certain majority agrees to the compromise or arrangement, the same shall bind the creditors, members, liquidators and contributories, "if sanctioned by the Court ." sub-section (2), advisedly, does not say that if a certain proportion of the creditors or members agrees to a compromise or arrangement, the Court shall sanction the same and thereupon the compromise or arrangement shall bind all concerned. Therefore, though the opinion of the creditors or members of the company must be given due weight, such an opinion does not conclude the question whether the scheme must be accepted. The opinion of the majority is only one of the elements in the case, to be considered by the Court which is called upon to sanction the scheme.

(13) Mr. Mistry, who appears on behalf of the respondents who propound the scheme did not initially dispute the proposition that the Court may refuse to sanction a scheme even if the requisite majority had agreed to adopt it. During the closing stages of his argument however he contended that though the Court may have jurisdiction to go beyond the verdict of the majority, the Court would not be justified in refusing to sanction the scheme unless it appeared that the consent of the majority was obtained by misrepresentation or by suppression of material facts. In view of this submission, it becomes necessary to examine the authorities cited at the Bar bearing on the question as to what is the extent of the jurisdiction of the Court in refusing to sanction a scheme to which the majority of the shareholders or creditors have agreed.

(14) Sub-sections (1) and (2) of S. 206 of the English Companies Act, 1948, are exactly similar to sub-sections (1) and (2) of section 153 of the Indian Companies Act, 1913. While dealing with section 206 of the English Act, it is observed in "Buckley on the Companies Acts." 13th Edition, page 409 as follows:

"In exercising its power of sanction the Court will see, first, that the provisions of the Statute have been complied with, secondly, that the class was fairly represented by those who attended the meeting and that the statutory majority are acting bona fide and are not coercing the minority in order to promote interests adverse to those of the class whom they purport to represent, and

thirdly, that the arrangement is such as an intelligent and honest man, a member of the class concerned and acting in respect of his interest, might reasonably approve.

The Court does not sit merely to see that the majority are acting bona fide and thereupon to register the decision of the meeting: but, at the same time, the Court will be slow to differ from the meeting, unless either the class has not been properly consulted, or the meeting has not considered the matter with a view to the interest of the class which it is empowered to hind, or some blot is found in the scheme."

(15) A similar statement can be found in Halsbury's Laws of England, 3rd Edition, Volume VI, page 768, paragraph 1553 That statement reads thus:

"The Court must be satisfied that the statutory provisions have been complied with, that the classes of creditors or members have been fairly represented by those who attended, and that the statutory majority approving the scheme is acting bona fide in the interest of the class it professes to represent. The arrangement must also be such as a man of business would reasonably approve, and fair and reasonable as regards the different classes if any"

(16) In re Alabama, New Orleans, Texas and Pacific Junction Rly. Co. (1891) 1 Ch 213, a petition was filed u/s 2 of the Joint Stock Companies Arrangement or compromise between a company and its creditors. The petition was accepted by the trial Court and the scheme was sanctioned. Two debenture-holders of the company filed an appeal from the decision of the trial Court and that appeal was heard by Lindley, L. J., Bowen L. J. And Fry L. J. Section 2 of the Joint Stock Companies Arrangement Act, 1870, which is reproduced in the judgment of Lindley L. J. at page 236 is in material respects similar to sub-section (2) of section 153 of the Indian Companies Act, 1913, and sub-section (2) of section 206 of the English Companies Act, 1948, In a passage at page 238 Lindley L. J. observes as follows:

". . . .what the court has to do is to see, first of all, that the provisions of that statute have been complied with; and, secondly, that the majority has been acting bona fide. The Court also has to see that the minority is not being overridden by a majority having interests of its own clashing with those of the minority whom they seek to coerce. Further than that, the Court has to look at the scheme and see whether it is one as to which persons acting honestly, and viewing the scheme laid before them in the interest of those whom they represent, take a view which can be reasonably taken by businessmen. The Court must look at the scheme and whether the Act has been complied with, whether the majority are acting bona fide, and whether they are coercing the minority in order to promote interest adverse to those of the class whom they purport to represent; and then see whether the scheme is a reasonable one or whether there is any reasonable objection to it; or such an objection to it as that any reasonable man might say that he could not approve of it."

Bowen L. J. observes at page 243 as follows:

"Then comes the more serious point, whether this is a compromise or arrangement which is within either the words of the section or within the true spirit of the legislation: that is to say, whether the Court has either jurisdiction to sanction it, or ought to sanction it. I do not think myself that the point of jurisdiction is worth discussing at much length, because everybody will agree that a compromise or agreement which has to be sanctioned by the Court must be reasonable, and that no arrangement or compromise can be said to be reasonable in which you can get nothing and give up everything. A reasonable compromise must be a compromise which can, by reasonable people conversant with the subject, be regarded as beneficial to those on both sides who are making it. Now, I have no doubt at all that it would be improper for the Court to allow an arrangement to be forced on any class of creditors, if the arrangement cannot reasonably be supposed by sensible business people to be for the benefit of that class as such, otherwise the sanction of the Court would be a sanction to what would be a scheme of confiscation. The object of this section is not confiscation. It is not that one person should be a victim, and that the rest of the body should feast upon his rights. Its object is to enable compromise to be made which are for the common benefit of the creditors as creditors, or for the common benefit of some class of creditors as such."

At page 245 Bowen, L. J. further observes.

"But the court has other things to consider before sanctioning a scheme which may injure persons who hold property and which is being enforced by a majority upon a minority. It is not, as it seems to me, at all compulsory upon the Court to register the decrees of a meeting simply because three-fourths in value of the meeting have given that assent which the statute renders a condition precedent to the jurisdiction of the Court. The Court has still to consider the circumstances."

Fry L. J. expressed the same view in the following words:

"Then the next inquiry is Under what circumstances is the Court to sanction a resolution which has been passed approving of a compromise or arrangement? I shall not attempt to define what elements may enter into the consideration of the Court beyond this, that I do not doubt for a moment that the Court is bound to ascertain that all the conditions required by the statute have been complied with; it is bound to be satisfied that the proposition was made in good faith and, further, it must be satisfied that the proposal was at least so far fair and reasonable, as that an intelligent and honest man, who is a member of that class, and acting alone in respect of his interest as such a member, might approve of its, What other circumstances the Court may take into consideration I will not attempt to forecast."

(17) In *re English, Scottish and Australian Chartered Bank* (1893) 3 Ch. 385, during the winding up proceedings of the chartered banking company a scheme of reconstruction was proposed under which a new bank was to be established

which would defray some of the liabilities of the old bank. The scheme was accepted by the trial Court and the appeal filed against that decision was heard by a Bench consisting of Lindley L. J., Lopes L. J., and A. L., Smith L. J. In this case also section 2 of the Joint Stock Companies Arrangement Act of 1870 fell to be considered and the question for decision was whether the Court was bound to sanction the scheme of reconstruction for the mere reason that the statutory majority had agreed to it. Lindley L. J. Adhered to the view expressed by him in the Alabama Case reported in (1891) 1 Ch. 213 and contended himself by reproducing passages from his own judgment and for the judgment of Fry L. J., in that case. After reproducing the passages, Lindley L. J. observes as follows:

".....Now, it is quite obvious from the language of the Act and from the mode in which it has been interpreted, that the Court does not simply register the resolution come to by the creditors or the shareholders, as the case may be. If the creditors are acting on sufficient information and with time to consider what they are about, and are acting honestly, they are, I apprehend, much better Judges of what is to their commercial advantage than the Court can be. I do not say it is conclusive, because there might be some blot in a scheme which had passed that had been unobserved and which was pointed out later.

While, therefore, I protest that we are not to register their decisions, but to see that they have been properly convened and have been properly consulted, and have considered the matter from a proper point of view, that is, with a view to the interest of the class to which they belong and are empowered to bind, the Court ought to be slow to differ from them. It should do so without hesitation if there is anything wrong: but it ought not to do so, in my judgment, unless something is brought to the attention of the Court to shew that there has been some material oversight or miscarriage."

Lopes, L. J. observes in his judgment at p. 414 thus:

". . . it is not sufficient for the Court to ascertain that the statutory conditions have been complied with; the Court must go further than that, and be satisfied that the statutory majority which are to bind the dissentient minority have acted bona fide that they have not acted adversely to those whom they professed to represent, and, lastly, that the arrangement contemplated is a reasonable arrangement, such as that which a man of business would reasonably approve, With regard to the word "reasonably," it must always be borne in mind the word "reasonably" is a relative term; it means reasonably with regard to the particular circumstances of the case. What is reasonable in one case might be unreasonable in another. The reasonableness must be always regarded with reference to other alternatives."

(18) In re Dorman, Long and Co. Ltd, and in re South Durham Steel and Iron Co. Ltd. (1934) 1 Ch. 635, two petitions were filed u/s 153 of the English Companies Act, 1929, which, in all material respects corresponds to section 153 of the Indian Companies Act, 1913. Maugham J. who dealt with the petitions says at

the outset of his judgment that it was plain that the duties of the Court u/s 153 are twofold:

"The first is to see that the resolutions are passed by the statutory majority in value and number, in accordance with section 153, sub-section (2), at a meeting or meetings duly convened and held. Upon that depends the jurisdiction of the Court to confirm the scheme. The other duty is in the nature of the discretionary power, and it has been the subject of two decisions in Court of Appeal, the first being the case of (1891) 1 Ch. 213 and the second case of 1893 3 Ch. 385."

Maugham J. then proceeds to deal with the views expressed in the Alabama Case and observes that Lindley L. J. did not probably intend to convey what he meant in saying in "a judgment which had not been reserved" that:

"The Court must look at the scheme, and see whether the scheme is a reasonable one or whether there is any reasonable objection to it, or such an objection to it as that any reasonable man might say that he could not approve of it."

Maugham J., preferred the language used by Bowen L. J. to the following effect, as representing the view of the Court of Appeal:

"A reasonable compromise must be a compromise which can, by reasonable people conversant with the subject, be regarded as beneficial to those on both sides who are making it," and

". . . . it would be improper for the Court to allow an arrangement to be forced on any class of creditors., if the arrangement cannot reasonably be supposed by sensible business people to be for the benefit of that class as such."

Maugham J, also cites with approval the following passage from the judgment of Fry L. J. In the Alabama Case 1891 1 Ch. 213:

"The Court must be satisfied that the proposal was at least so far fair and reasonable as that an intelligent and honest man, who is a members of that class, and acting alone in respect of his interest as such a member, might approve of it."

After reviewing the decisions in the Alabama Case 1891 1 Ch 213 and the Chartered Bank Case (1893) 3 Ch 385 Maugham J, expressed his conclusion at page 657 thus:

".. .. what I have to see is whether the proposal is such that an intelligent and honest man, a member of the class concerned and acting in respect of his interest, might reasonably approve."

(19) Turning to Indian decisions, the one reported in Calicut Bank Ltd. Vs. Devani Ammal and Others, takes the view that the fact that shareholders and creditors of a company have approved a scheme of compromise as contemplated by S. 158 of the Indian Companies Act does not mean that the Court is bound to

accept the scheme. Leach C. J. who delivered the judgment of the Division Bench says:

"It is the Court's duty to examine the proposals.. .. but there may be more important considerations."

It was held in that case that the position of the company was misrepresented in the meeting of the shareholders and creditors of the company and, therefore, the view of the majority could not be accepted. It was further held that even if the resolution passed by the shareholders and creditors had been passed after a disclosure of the true position, the scheme could not be accepted, because, amongst other things, the company was hopelessly insolvent.

(20) "In the matter of Bharati Central bank, Ltd." ILR (1949) 1 Cal 127 is the decision of a single Judge who held that in sanctioning a scheme of arrangement u/s 153, the Court is not bound to follow the decision of the creditors and shareholders approving the scheme. It must be satisfied that the provisions of the Act have been complied with, that the scheme is a reasonable and workable one, that the creditors and shareholders had sufficient information with regard to the affairs of the company before approving the scheme, that the creditors and shareholders acted in good faith in approving the scheme and that there are no considerations of public interest which would override the decision of the creditors and shareholders. In support of this decision, the learned Judge relies on the judgments of Lindley L. J. in the Alabama Case 1891 1 Ch 213 and the Chartered bank Case 1891 3 Ch 385. The scheme which was approved by the creditors was rejected by the learned Judge on the ground that it was not practical, that its success was highly problematical, that it was not reasonable and to sanction the scheme was to stifle all inquiry into the conduct of the management and the Managing Directors by putting premium on what may eventually be commercial immorality.

(21) In Bengal Bank Ltd. Vs. Suresh Chakravartty and Others, , a Division Bench rejected a scheme on the view that though the agreement of the majority as required by section 153 (2) is a pre-requisite for confirmation of the scheme by the Court, it will not sanction the scheme, merely because the scheme has been approved by the requisite majority. In sanctioning a scheme, the Court must see that it is reasonable and practical and its function does not end with ensuring that the majority is acting bona fide. A word of caution is uttered in the judgment by saying that the Court should be slow to differ from the view of the majority unless either the class has not been properly consulted or the meeting has not considered the matter with a view to the interest of the class which it is empowered to bind, or some blot is found in the scheme. In support of this view, reliance is placed by the learned Judges on the passage from "Buckley on the Companies Acts" which we have cited above.

(22) On a review of these authorities and from the provisions in section 153(2) of the Indian Companies Act, 1913, it seems to us clear that the consent of the

majority of creditors or shareholders to a scheme does not conclude the issue whether the scheme should be sanctioned. The jurisdiction of the Court which is called upon to sanction a scheme transcends the mere consideration that a majority of those affected by the scheme is willing to submit to the scheme. The creditors of a company may agree to accept a fraction of the amount due to them from the company and yet, on considerations of more lasting importance, like public or commercial morality, the Court refuse to accept the verdict of the majority. It may also refuse to accept the scheme on the ground that it is not reasonable or that it is not feasible or that there is no chance that it will yield to a smooth and satisfactory execution. By "reasonable" is generally meant that the arrangement cannot reasonably be supposed by sensible business people to be for the benefit of the class which they represent. The Court will also not sanction the scheme if the facts which would have influenced decision of the majority were not known or disclosed to the majority, or if the sponsors of the scheme have misrepresented the true position of the company. Finally, if the acceptance of the scheme would lead to the stifling of an inquiry into the conduct of the delinquent directors, the Court would be slow to give its sanction to the scheme. Considerations such as those mentioned above must be taken into account by a Court before a scheme is sanctioned but in the very nature of things, it is not possible to enumerate exhaustively the circumstances which a Court is entitled to take into consideration.

(23) In our opinion, therefore there is no substance in the submission of Mr. Mistry that the decision of the majority must necessarily lead to the inference that the scheme is for the benefit of that class which was represented in the statutory meeting. It is undoubtedly true that the verdict of the majority must be given due weight, because implicit in that verdict is the inference that those whose interests are likely to be affected by the scheme are willing to submit to it. As we have, however, stated earlier, the view of the majority is but one element in the case, though a very important one, which must be taken into account in sanctioning the scheme. The view of the majority is not decisive.

(24) We must now turn to the more important clauses of the scheme in order to show why the scheme cannot be sanctioned. A scheme of reconstruction of a company which is ordered to be wound up must postulate that on some reasonable hypothesis it is possible to revive the business of the company. The assets of this Company are so meagre and its liabilities so large that it is in a state of hopeless insolvency. From that state it would, in our opinion, be impossible to resuscitate it. Mr. Mistry has submitted to us two statements as regards the position of the company one under the scheme and another, without the scheme. The statement prepared by Mr. Mistry as reflecting the position of the company under the scheme is open to certain objections, but even assuming that it truly reflects the financial position of the company, it is clear that the company is wholly insolvent. According to the statement submitted by Mr. Mistry, the company will have assets of the value of Rs. 6,73,000 and liabilities amounting to Rs. 7,24,500, under the scheme. It is difficult to see how the

company is going to function without any running capital and without any liquid assets. We must also mention that the liabilities shown in the statements tendered before us by Mr. Mistry ignore many other liabilities which the company shall have to meet. For example, the arrears of tax have been shown in the statement at Rs. 32,000 when, in fact, the company will have to pay a much larger amount under that head. If the building on the Laxmi Road belongs to the company, and that is the decision in the suit filed by the Liquidators against the Managing Directors, the company will have to pay Income Tax on the monthly rent received during the course of the last many years. The Managing Director had made an unfounded claim that the building belonged to him and the rent was not taxed in his hands, because it is said that his income was less than the minimum taxable.

(25) The total debts of the company can be taken roughly at Rs.7,44,000. if the personal debts of the Managing Director amounting to Rs. 1,57,000 which under the scheme are passed on to the company are added to it, the total liability of the company would come to Rs. 9,01,000. About Rs, 1,20,000 were paid by the Liquidators as interim dividend and, therefore, a sum of Rs. 7,81,000 is still due from the company by way of debts.

(26) As against these debts, the assets of the company consist of a vacant plot of three acres which under the scheme is to be sold for Rs. 1,85,000, another plot of three acres which yields a monthly rent of Rs. 2,100, a building on the Laxmi Road which yields an income of Rs. 1,300 per month and about Rs. 43,000 which are lying to the credit of the company as rent of the building on the Laxmi Road.

(27) Under clause (f) of the scheme, Rs. 1,87,000 would have to be paid to the creditors in partial satisfaction of their dues at 25 paise in rupee. The sale-proceeds, therefore of the three acres of land at Yerandavana shall have been used for the purpose of paying debts partially. Under clause (g) of the scheme debentures of the value of Rs. 2,02,500 bearing interest at 7 1/2 per cent per annum are to be issued in favour of the creditors. The interest on the debentures alone would come to Rs. 16,000 per annum. Under clause (i) (a) of the scheme, a cash amount of Rupees 70,000 is required to be paid to the so-called secured creditors of the Managing Director. The sum of Rs. 43,000 which is lying to the credit of the company as rent of the Laxmi Road property can be used to meet this liability but a balance of Rs. 27,000 will still remain outstanding against the company.

(28) Under clause (i) (b) of the scheme, debentures of the value of Rs. 30,000 bearing interest at 7 1/2 per cent per annum are to be issued in favour of the personal creditors of the Managing Director. The interest on these debentures will come to Rs. 2,250 per year. Under the same clause a mortgage is to be created in favour of some of the creditors of the Managing Director, in the sum of Rupees 57,000, with the interest at 6 per cent per annum. The interest on the mortgage will come to Rs. 3,420 per year.

(29) The first question which one might consider is from where will the company pay even the interest to the secured creditors. The interest payable to the two classes of debenture holders and the mortgages comes to Rs. 21,670 per year. The only source of income to the company today is the rent of Rs. 2,100 per month from the three acres of plot which is in the possession of two companies called the Bajaj Electrical Limited and the Hunar Caustics Limited and the rent of Rs. 1,300 per month from the Pioneer House at Laxmi Road, Poona. Excluding four months rent for taxes, repairs and out goings the company will receive a sum of Rs. 27,200 per year by way of rent. The best part of this amount shall have to be utilised for paying the interest on the debentures and the mortgages, with the result that the company will not be left with any capital to carry on its business. It is urged by Mr. Mistry that under the scheme, the company would issue fresh shares for subscription by the public and the public may come forth to buy the shares. This possibility seems to us far too optimistic. A company which has gone in liquidation, which for over ten years is unable to meet its obligations and whose affairs are in such a state that it cannot raise fresh capital. The possibility, therefore, that the company may be able to raise capital for its business must be excluded. Therefore, if the scheme is accepted, all that can happen is that the evil day will be postponed. We see no justification for prolonging the agonies of the creditors any more. It seems to us certain that even if the scheme is accepted, the company will have to face a fresh challenge to its solvency within a short time.

(30) The second reason why the scheme cannot be sanctioned is that its object appears to us to be to cover the deeds of delinquent directors. In Civil Suit. No. 835 of 1955 which was filed by the Official Liquidators against the Managing Director and another person for a declaration that the building called "Pioneer House" on the Laxmi Road, Poona, is of the ownership of the company, the trial Court held that the Managing Director had made a false claim to the building, that he had manipulated accounts to suit his convenience and that he had not acted in the best interests of the company. The decree of the trial Court was confirmed in appeal by the Extra-Assistant Judge, Poona, who also held that the Managing Director was guilty of fraud. The Managing Director had filed an appeal in this Court from the judgment of the learned Extra-Assistant Judge, being Second Appeal No. 925 of 1959, but that appeal was withdrawn during the hearing of this appeal. We explained to the learned counsel appearing for the Managing Director that the withdrawal of the appeal will not efface the finding of fraud, but counsel stated that he was conscious of that position but had advised his client that it was not in his interest to prosecute the appeal. If the scheme is sanctioned, the winding up order will stand set aside, the liquidators will be discharged, there will be none to prosecute the misfeasance summons against the erring directors and the assets of the company will once again fall into the hands of persons whose rectitude is under a cloud. That cannot be permitted under the cloak of a scheme of reconstruction.

(31) The third reason why the scheme cannot be sanctioned is that it provides by clause (i) (a) that the personal debts of the Managing Director, amounting to Rs.

1,57,000, should be taken over by the company. It seems to us utterly unreasonable that the company should undertake to discharge the personal liabilities of the Managing Director. While justifying this provision, the scheme resorts to some mathematics and a little logic both of which are fictitious. In fact, the adoption of such a provision by the creditors shows that they gave their consent to the scheme without appreciating its real implications. In the language of the decision in the Alabama case, this part of the arrangement is not such as men of business would reasonably approve.

(32) We would like to draw attention to a few other provisions of the scheme which appear to us unreasonable and impractical. Under clause (d) of the scheme, the vacant plot at Yerandavana measuring about three acres is required to be sold by private treaty for a sum of Rs. 1,85,000. We see no reason why the property should be sold privately. Public offers have never been invited for the sale of this property and not even a formal valuation of the property has been made. The decision, therefore, that the property should be sold at Rs. 1,85,000 strikes us as arbitrary and unreasonable. The location of the property, its extent and its potentialities indicate that the property is capable of fetching a much higher price.

(33) Under the earlier part of clause (i) (a) of the scheme, the Managing Director agrees to transfer the land under the building "Pioneer House", to the Company for a consideration of Rs. 47,000. It is difficult to appreciate that men of business knowing their interest would agree to such a provision. The Managing Director had made a false claim to the building which belongs to the company. He agreed to sell the building to Yeshwant Mutual Insurance Co. Ltd., and took an earnest of Rs. 47,000 from them. He put the Insurance Company in possession and during the course of the last few years that Company has recovered by way of rent an amount larger than the one which it had paid by way of earnest. The Insurance Company has been taken over by the Life Insurance Corporation of India which has very properly taken the view that it will not enforce the agreement of sale. It is content that the amount paid by way of earnest has already been recovered in the shape of rent. It would be clear from these facts that the Managing Director has wrongly appropriated to himself the sum of Rupees 47,000. It, therefore, seems to us strange that he should be said to have transferred the land to the company for a consideration of Rupees 47,000. The company today is in possession of the building as well as the land and whatever may be the complications arising out of the dual ownership of the building and the land, the company could not be dispossessed, save through a proper action.

(34) Finally, as we have stated earlier, the object of a scheme of reconstruction must be to enable the company to tide over a temporary difficulty and re-establish its business. This company has not only large liabilities and meagre assets but as matters stand today it has neither a place to carry on its business nor the equipment with which to conduct it. The company owns six acres of land, three acres from out of which are to be sold under the scheme. The remaining

three acres are in the possession of the Bajaj Electricals Limited and the Lunar Caustics Limited. The building on the Laxmi Road is mostly in the possession of tenants and, besides, the company will not be able to do its business in the building. That is about the place of business. As regards the machinery and equipment, the entire machinery which belonged to the company and with which it used to conduct its business has been sold by the liquidators for Rs. 1,20,000. It is from this amount that the liquidators had paid an interim dividend of 19 paise to the creditors. If the company has to start its business afresh, it will have to find a place first which in Poona is neither easy nor cheap to obtain and it will then have to buy the equipment and the machinery for which a considerable amount would have to be expended.

(35) Mr. Mistry says that the business of dyeing and printing cloth which the company used to do does not require a large capital or an expensive machinery. It is not possible to agree with this submission. The balance-sheet of the company at exhibit 85 would show that in 1950 it had stock in hand worth about Rs. 92,000 and in 1951, the stock-in-hand was worth about Rs. 61,000. Dyes and Chemicals in the respective years were of the value of Rs. 52,000 and Rs. 40,000. As stated earlier, the company has hardly any means to pay the interest on the outstanding debts. It seems to us impossible that it will be able to raise any amount for the purchase of the equipment and the machinery needed for its business. The scheme is so unrealistic and impractical that it does not even attempt to visualise where and with what equipment the company will do its business.

(36) We will only cite one more reason why the scheme should not be sanctioned. That reason is by no means the least important. After the trial Court decided Suit No. 835 of 1955 in respect of the building at Laxmi Road, the Official Liquidators filed a misfeasance summons on the 2nd November 1957 against the Managing Director and three other directors of the company. The misfeasance summons was stayed during the pendency of the second appeal filed by the Managing Director in this Court. The fact that the misfeasance proceedings were taken against the directors of the company is not shown to have been disclosed to the shareholders and creditors of the company. While considering the scheme, it was highly relevant whether the conduct of the Managing Director and the other directors was such that the fate of the company could be put in their hands. If the creditors were told that a Court of law had held that the Managing Director was guilty of fraud as against the company and if they were further told that misfeasance proceedings were taken against the Directors, their decision on the approval of the scheme could have been easily otherwise.

(37) It is urged by Mr. Mistry that it was the duty of the Official Liquidators to disclose to the creditors and the shareholders that misfeasance proceedings were taken against the directors. The question, in our opinion, is not who is to blame for the nondisclosure of such an important fact, but the question is whether

material facts were before the shareholders and creditors who had met to consider the scheme. We are not surprised that the sponsors of the scheme did not disclose to the meeting that misfeasance proceedings were pending, because two of the sponsors of the scheme. Gopal Ganesh Ketkar and Achyut Dattarya Phatak figure as delinquent directors in those proceedings. The Managing Director of the company against whom also misfeasance proceedings are taken is the father of Achyut Dattatraya Phatak. It seems to us clear that if the creditors and shareholders were apprised that misfeasance proceedings were taken against the Directors of the company, they would not have approved the scheme under which the affairs of the company are once again relegated into the hands of the self-same directors.

(38) For these reasons, we are of the view that the learned District Judge was in error in giving his sanction to the scheme. We accordingly allow the appeal and direct that winding up proceedings will continue.

(39) The respondents will pay to the Liquidators the costs of this appeal and of the proceedings in the District Court.

(40) Receiver will stand discharged.

(41) Rule in Civil Application No. 2793 of 1965 stands discharged with costs.

(42). Order accordingly.