

(2002) 10 KAR CK 0003
In the Karnataka High Court
Case No : Company Petition No. 97 of 2002

Kirloskar Electric Company Limited

APPELLANT

Vs

Nil

RESPONDENT

Date of Decision : 22-10-2002

Acts Referred:

Companies (Court) Rules, 1959 — Rule 9
Companies Act, 1956 — Section 391, 394

Citation : (2003) 1 KarLJ 556 : (2003) 1 KCCR 64 SN

Hon'ble Judges : H.L. Dattu, J

Bench : Single Bench

Advocate : A.N. Jayaram, for Jayaram and Jayarma, K.G. Raghavan, for ICICI, R.B. Deshpande, for Objector, Vishwanath Shendge, Additional Central Government Standing Counsel for Registrar of Companies, Samarthana Associates, for Objector and H.S. Srinivasa Murthy, for Opposing Creditor, for the Appellant; H.S. Srinivasa Murthy, for Opposing Creditor, for the Respondent

Final Decision : Dismissed

Judgement

H.L. Dattu, J.—Kirloskar Electric Company has filed this company petition under Sections 391 to 394 of the Companies Act, 1956 ("Act", for short), inter alia requesting this Court to sanction the scheme of arrangement annexed as Annexure-B to the petition, so that the same becomes binding on all the shareholders, creditors of the petitioner-company as well as on the petitioner-company.

2. The petitioner-company was incorporated as a public limited company on 26th day of July, 1946 under the provisions of the Mysore Companies Act, 1938, under the name and style of M/s. Kirloskar Electric Company Limited. Its registered office is situate at the Industrial Suburb, Rajajinagar, Bangalore. The authorised share capital of the company is Rs. 700,000,000 (Rupees seven hundred million) divided into 40,000,000 (forty million) equity shares of Rs. 10/- each and 3,000,000 (three million) preference shares of Rs. 100/- each. The issued, Subscribed and paid up share capital is Rs. 25,268,817 (twenty-five million two

hundred and sixty-eight thousand eight hundred and seventeen) equity shares of Rs. 10/- each and 1,800,000 (one million eight hundred thousand) preference shares of Rs. 100/- each. The main object for which the company was incorporated was to manufacture electric apparatus and appliances required for or capable of being used in connection with the generation, distribution, supply, accumulation and employment of electricity, produce a wide range of electrical motors, alternators, traction equipments, rotating machines, transformers, switchgears, voltage regulators, industrial electronics, automotive controls, etc.

3. The petitioner-company has explained the reasons, which necessitated the formation of the scheme and also the benefits under the scheme to the company, to its shareholders and creditors. They are:

"a. The petitioner-company has a dominant market position in large and medium sized rotating machines and traction equipments and over the years it has built reputation and the company enjoys goodwill in the domestic and foreign markets and the company was having sound financial position till about 1997-98.

b. The company's profitability started getting affected from 1998-99 onwards on account of the recession in capital goods industry, downturn of infrastructure and core sectors, which are generally the end users of the company's products. The capital goods industry including the petitioner-company made substantial investments in the core sectors in the mid-nineties in anticipation of good demand from infrastructure and core sectors which did not materialise and thereby affecting the performance of the company and resulting in the company incurring losses. Additional interest on huge borrowings at high rate of interest exacerbated the position. Decline in sales during the last three years affecting the profit margin and competitive pressures due to over-capacity in the industry coupled with longer credit periods to customers apart from the following, are the circumstances that have necessitated the proposed arrangement.--

High level of debt (Rs. 305 crores);

Excess labour force and high employee cost of 24% of sales in the year 2000-2001;

High interest cost at 23% of sales in the year 2000-2001; High level of receivables; Continuing large losses;

Continuing poor financial situation, which can lead to reluctance on the part of the suppliers and others to continue their support;

Threat of legal cases from creditors/statutory authorities".

4. The Board of Directors of the company have approved the scheme of arrangement and the scheme is annexed to the main petition. The latest audited balance-sheet is also produced as one of the annexures to the petition.

5. The petitioner-company had filed Company Application No. 134 of 2002 u/s 391(1) of the Companies Act, 1956, praying for directions, for convening the

meetings of the equity shareholders, secured and unsecured creditors for examining and if thought fit to approve with or without modification the scheme of arrangement proposed by the petitioner-company. The summons came up for directions before this Court on 14th March, 2002, and this Court directed different meetings of different persons interested in and affected by the scheme of arrangement to be convened and appointed Mr. Vijay R. Kirloskar, as Chairman to preside over the meetings. The Court had further directed the petitioner-company to advertise the company petition in one edition of "Times of India" newspaper and one edition of "Prajavani" newspaper, inviting objections, if any, from the persons, who would be affected by the proposed scheme of arrangement. Before the meetings were convened, the Chairman had issued notices of the meetings individually to the secured creditors, unsecured creditors including fixed deposit holders and equity shareholders of the company and had annexed to the notice the whole scheme as proposed by the petitioner-company and explanatory statement as required u/s 393 of the Companies Act.

6. The report submitted by the Chairman appointed by this Court to hold the meetings gives a picture of what transpired at each meeting.

6-A. The meeting of equity shareholders was held at 3.00 p.m. on 26th April, 2002 at the registered office of the company situate at Industrial Suburb, Rajajmagar, Bangalore. This meeting was attended by 910 equity shareholders either personally or by proxy. Their aggregate holding is 1,42,25,793 equity shares of Rs. 10/- each aggregating to Rs. 14,22,57,930/-. The report shows that the scheme of arrangement sponsored between Kirloskar Electric Company Limited and its members and creditors have been approved by a majority of 1,42,22,428 votes as against 424 votes.

6-B. The meeting of the secured creditors was held at 10.00 a.m. This meeting was attended either personally or by proxy by 18 secured creditors of the company and the total value of their debt is Rs. 2,53,36,43,391/- and from the report it appears, certain amendments were moved by the secured creditors to the proposed scheme of arrangement between Kirloskar Electric Company Limited and its members and creditors and as modified by the amendments carried out at the meeting, the scheme was approved by a majority of 1,47,73,91,975 votes against 35,65,67,300 votes. The amendments moved and passed at the meetings modify the scheme of arrangement to a certain extent insofar as allotment of equity shares to the secured creditors. Therefore, it can be said that the secured creditors or those claiming to be the secured creditors have accepted the scheme as it is now being proposed. The amendments suggested and approved in the meeting is as under:

"(i) Delete the following in Part II(ii) of the scheme.-

"No party (Financial Institutions/Banks or KECL) shall dispose of the shares held in RMG without the written consent of others for a minimum period of three years from the date of allotment".

(ii) Add the following under Part II(ii) of the scheme.--

"In the eventuality of a divestment of equity stake in RMG to a joint venture partner or otherwise, the right of first refusal would be available to the lenders holding equity stake in RMG. Only after satisfying the demand the lenders holding equity stake in RMG would the other shareholders have an option to dispose their respective stakes" ".

6-C. The report also indicates the pattern of voting of the secured creditors and some of the suggestions made in the meeting. The same is as under:

"The outcome of the voting on the approval of the Scheme, as stated hereinabove, is that 12 secured creditors representing 81% in value of the total number of votes polled by secured creditors present and voting have voted for the scheme unconditionally as against 3 secured creditors representing 19% in value voting against the scheme. Two secured creditors, Bank of India and Bank of Baroda voted for the scheme subject to certain conditions. Their approval being condition, their votes have been held invalid. All other secured creditors approving the scheme have voted for the scheme of arrangement unconditionally. During the meeting, some of the secured creditors had given letters requiring the company to comply with certain conditions, to which the Chairman specifically informed them that the conditions were administrative in nature and did not relate to modification of the Scheme being considered and that they have to take decision in the matter of approval unconditionally".

6-D. The meeting of the unsecured creditors and creditors was held at 11.30 a.m. on 26th April, 2002. The meeting was attended either personally or by a proxy by 401 unsecured creditors of the company and the total value of their debt is Rs. 25,29,76,149.07 ps. The scheme of arrangement proposed between the petitioner-company and its members and creditors have been approved in the meeting by a majority of votes of 24,91,52,868.10 votes against 38,23,380.97 votes."

6-E. The next important equity shareholder and the secured creditor of the company is IDBI Limited. The preference shares issued by the company is held by IDBI Limited only. In the report of the Chairman, it is stated that the meeting of the preference shareholders as such was not convened to ascertain their views, but by a communication, they were requested to convey their acceptance or otherwise of the scheme. It is also stated that IDBI Limited as a secured creditor had attended the meeting of secured creditors but it abstained from voting to the proposed scheme of arrangement between the petitioner- com; any and its members and creditors. At the time of hearing of the petition, petitioner-company has produced a communication of IDBI Limited to it dated 26th July, 2002, wherein it is stated that IDBI Limited in principle would, agree with the de-merger of the petitioner- company and the final approval shall be subject to the modifications to the scheme or additional conditions, if any, as may be stipulated by IDBI Limited.

7. An important aspect which requires to be noticed at this stage itself is that the day on which the meetings of the shareholders and creditors was convened for the purpose of considering and, if thought fit, approving with or without modification, the proposed scheme of arrangement, the Chairman, who was appointed to convene the meetings for the reasons best known to him and the company had not brought to the notice of the shareholders and the creditors about the reference made by the petitioner-company u/s 15(1) of the Sick Industrial Companies (Special Provisions) Act, 1985, before Board for Industrial and Financial Reconstruction. This information is stated only now in the present petition. Whether this would have made any difference or not, which is another moot issue, which may not be necessary to consider in this petition, since none of the members or creditors have taken objections in this regard.

8. The petitioner-company by providing the aforesaid material before this Court states, that the formalities for approaching this Court has been complied with by the petitioner-company and the sanction of the scheme by this Court would be beneficial to the company, if shareholders and creditors therefore request this Court in this petition filed under Sections 391 to 394 of the Act to sanction the scheme of arrangement so as to be binding on all the members, secured creditors, unsecured creditors of the petitioner-company as well as on the petitioner- company.

9. Along with the company petition, the petitioner-company has also filed an application under Rule 9 of the Companies (Court) Rules, 1959, inter alia seeking the permission of this Court to sell a part of its immovable asset as provided in the scheme of arrangement for the reasons stated in the affidavit filed along with the application. However, the prayer so made was not seriously pressed by the applicant company before this Court. When the main petition was posted before this Court on 5-6-2002, the Court was pleased to issue notice of the petition on the Regional Director, Department of Company Affairs, and also had directed the petitioner-company to take out notice of the company petition in one edition of "Times of India" newspaper and in one edition of "Trajvani" Newspaper, fixing the date of hearing as 11-7- 2002.

10. The directions issued by this Court have been faithfully carried out by the petitioner-company. In response to the notice issued, the Regional Director, Department of Company Affairs, Chennai, has filed his objections opposing the proposed scheme of arrangement between the petitioner-company and its members and creditors. I will refer to their objections a little later. Similarly, in response to the advertisement issued in leading newspapers, some of the secured and unsecured creditors had initially filed their objections, opposing the proposed scheme of arrangement and at the time of hearing of the petition, most of the objectors have withdrawn their objections. The only objectors, which are left out to oppose the proposed scheme of arrangement, are the parties represented by Sri Arun, Mr. D. Peveira and Sri H.S. Srinivasa Murthy, learned Counsels.

11. The Regional Director, Department of Company Affairs, Chennai, to whom notice was issued u/s 394-A of the Companies Act, 1956, has filed his representation as required by law. In the representation filed, the following objections have been taken by him:

I. The scheme was approved by the requisite majority of unsecured creditors and equity shareholders. However, it was approved only by 58.31% of the secured creditors present and voting in the meeting with certain modifications as specified in para 12(2) of the petition. In this connection, it is submitted that in terms of Sub-section (2) of Section 391 of the Companies Act, 1956, approval of majority in number representing three-fourths in value of the creditors or class of creditors or members or class of members, as the case may be present and voting either in person or where proxies are allowed by proxy is required, so that the scheme is binding on all the creditors or all the creditors of the class, all the members or all the members of the class, as the case may be, and also on the company. Since the scheme has not been approved by the requisite majority of the secured creditors, apparently it is not binding on all the secured creditors.

II. There should have been separate meeting of preference shareholders and secured creditors of the company, namely, IDBI Limited and in the absence of consent by the preferential shareholder of the company, the sanction for the scheme of arrangement cannot be granted; and

III. As per the scheme, some of the divisions/undertakings of the petitioner-company will be de-merged/hived off and transferred in favour of M/s. Kaytee Switch Gear Private Limited and M/s. Best Trading Agencies Limited. But the transferee/resulting companies have not filed any petitions before this Court and in the absence of the same, the scheme is silent as to how it would be binding on all these entities.

12. In response to the representation so filed by the Regional Director, M/s. Best Trading Agencies and M/s. Kaytee Switch Gear Private Limited, who are in fact the transferee companies under the proposed scheme of arrangement have filed applications under Rule 9 of the Companies (Court) Rules, 1959, inter alia seeking permission of this Court to come on record in these proceedings and to dispense with the meetings of the shareholders and creditors of the applicant companies and further to proceed to consider the plea for sanction of the scheme of the petitioner-company, on the basis that the applicants will be bound by the terms of the scheme insofar as it applies to the applicants.

13. The next unsecured creditor, who is claiming unpaid licence fee is Kirloskar Proprietary Limited. This proprietary concern contends that it had authorised under an agreement to the petitioner-company for the user of its trademarks "Kirloskar" in the corporate name of the petitioner-company as also on its stationery and the said agreement has been terminated by their letter dated 24-1-2001, and therefore petitioner-company cannot include in the user of trademarks "Kirloskar" in the benefits proposed to be made available to M/s.

Kaytee Switch Gear Private Limited. Therefore, submits that in the event this Court sanctioning the scheme, the aforesaid objectionable part thereof be deleted from the proposed scheme. This objection of the objector is seriously disputed by the petitioner-company.

14. The other objector to the proposed scheme of arrangement is State Bank of Travancore, which is another secured creditor. Its claim is that the accounts of the petitioner-company have become highly irregular and the petitioner-company is indebted to it in a sum of Rs. 1030.98 lakhs and that does not include interest from 1-10-2000 onwards, as the accounts have become non-performing assets from 30-9-2000. According to the objector, even after the proposed restructuring, it will not be possible to service the debts of the company and the proposed scheme will only postpone the repayment and thereby further increasing the costs of servicing the debts. It is further stated that the valuable real estate of the company in Bangalore is proposed to be sold as a part of the scheme of arrangement and that will substantially dilute the level of security for the facilities proposed to be extended to RMG and residual KECL entities. The other objection seems to be that the petitioner-company has been incurring heavy losses for a long time and shifting of units away from Bangalore cannot make the operation profitable and even after the clearing of Rs. 312 lakhs as proposed in the scheme, the remaining fund based exposure of Rs. 697 lakhs will remain a non-performing asset and the same is not acceptable to them. Along with their objections, they have also filed an application for condonation of delay in filing the opposing creditors affidavit. The petitioner-company has filed its objections to the prayer made in this application and also to the opposing creditors affidavit. The statement made by them in the counter-affidavit requires to be reproduced in extenso:

"The shifting of the operations of the Bangalore Unit to a new location is necessary to make available the real estate at the existing unit for paying off the debts in Special Purpose Vehicle (SPV). The shifting will also improve the operational efficiencies as common processes will be integrated and shared. The units at Mysore, Hubli and Tumkur will continue at the existing locations. Under the Scheme, the Bank is given first *pan passu* charge for Rs. 555 lakhs on the fixed assets and a second *part passu* charge on current assets and for the balance amount, it will have a first *pari passu*, charge on current assets and a second *pari passu* charge on fixed assets. Since Debt Servicing Capital Ratio (DSCR) is at acceptable level and RMG and residual KECL, both are profitable companies, account of the Bank will not be a Non-Performing Asset (NPA). It is also submitted that the petitioner has not sought for any higher non-fund based facility than the sanctioned existing limits. Thus viewed in any way, the Bank's interests remain unaffected and are in fact better protected and there is no legally justifiable reason for the Bank to object to the scheme".

15. ICICI Bank Limited, the single largest creditor of petitioner-company has filed an application accompanied by an affidavit u/s 391(1)(b) of the Companies Act,

with a request to modify the scheme by enabling the applicant to hold upto 19% of the shareholding in the SPV by themselves and in their name and further to nominate such person or persons as the applicant may deem fit to hold the shareholding in SPV, such that their shareholding put together does not exceed 56% of the shareholdings to which the applicant is entitled under the proposed scheme and according to them, the modification proposed does not vary the scheme of arrangement in any manner from what was originally envisaged and the proposed modification also does not prejudicially affect the interest of the other secured creditors. The request made in this application is not opposed by the petitioner-company either by filing a counter-affidavit or opposing it at the time of hearing of the petition.

16. Kirloskar Electric Company Employees" Association is the representative Trade Union of the workmen of the petitioner-company. Without even a notice issued to them by this Court, its President was sitting all through the hearing of the company petition and when this Court expressed some reservation about the merits of the scheme qua the interest of the concerned workmen, he readily files an affidavit before this Court expressing the approval of the workmen's association for the sanction of the scheme without any reservation/modification in the proposed scheme of arrangement. The affidavit filed is placed on record and it forms part of these proceedings.

17. Having noticed the pleadings, now let me notice the material terms of scheme of arrangement and they are as under:

I. Petitioner-company has been carrying on the business of manufacturing and selling AC and DC motors, AC and DC generators, Transformers, LT/HT Circuit Breakers/Switch Board, Industrial Electronic Voltage Regulators, Traction Equipment, Controls for Alternators, etc., in the factories at Bangalore, Hubli, Tumkur and Mysore.

II. After its incorporation under the provisions of Mysore Companies Act, 1938, the company was progressing well, but subsequently in the year 1998-99 onwards, it weathered heavy storm for multi-various reasons and as on 30th September, 2001, the debt level of petitioner- company is over Rs. 30,500 lakhs.

III. The overall debt burden has become unserviceable in the context of current performance of capital goods industry. It is felt that unless the debt of the company is restructured, the survival of the company will be jeopardized. The main objective of restructuring is to address the weakness of the company without relying on the external debts for funding of rehabilitation needs and to leverage the internal assets of the company to the extent possible.

IV. The detailed technical feasibility report for relocation and consolidation of manufacturing facilities has been made by technical team of KECL. The manufacturing unit for large motors/generators (part of Unit 1) and DC machines and traction equipment (Unit 3) will be consolidated at a new location to derive advantages of sharing of common facilities, minimizing material flow, higher

productivity and reduction of employee costs. In this connection, ICICI (lead institution) at the request of consortium of Banks and term lenders has obtained report from an independent technical consultant, who has confirmed the feasibility and rationale of relocation as proposed in the scheme. The above said consolidation of manufacturing facilities will also enable elimination of duplication of certain machine shops. The company would also derive the advantage of cost reduction by outsourcing some of the components and services at lower costs. The surplus machinery as a result of the consolidation will be sold through a Special Purpose Vehicle. Accordingly, with a view to consolidating the production facility, to reduce overheads and to unlock the real asset value at Bangalore the following operational restructuring is proposed.--

- * Shift Unit 1 (AC Machines - Small and Medium Plant) from Bangalore to Hubli.
- * Shift Unit 1 (AC Machines - Large and Extra Large Plant) from Bangalore to a new location near Bangalore.
- * Shift Unit 3 (DC Machines and Traction Plant) from Bangalore to a new location near Bangalore.
- * Shift Unit 5 (Transformers Plant) from Bangalore to Mysore.
- * Shift Unit 10 (Switchgear Plant) from Hebbal, Bangalore to Mysore.
- * Shift PSG from Bangalore to Mysore.

Subsequent to such operational restructuring, there will be two business groups namely, (i) Rotating Machine Group (RMG) at Hubli/New Locations near Bangalore, Tumkur, Spares Division in Bangalore and Wind Mills (REG) in Karnataka and Tamil Nadu; and (ii) Static Equipment Group (SEC) at Mysore. The rationale for segregation into the two business groups is to consolidate operations based on the respective synergies and to develop the vehicle for exploring the joint venture/strategic alliance for the Rotating Machine Group. The value of the large real estate assets belonging to the company viz., land and buildings at Malleswaram in Bangalore, will be unlocked upon implementation of operational restructuring. The real estate value can be suitably leveraged for reducing the debt burden on manufacturing operations.

V. In the dictionary clause of the scheme, meaning of the expressions like "appointed date, effective date, Rotating Machine Group and Special Purpose Vehicle" is defined. The "appointed date" means, the September 30, 2001 or such other date as the Hon"ble Court may direct. The "effective date" means the date on which the certified copy of the order of the Hon"ble High Court of Karnataka sanctioning this scheme is filed with the Registrar of Companies in Karnataka. "Rotating Machine Group" (RMG) means the following businesses being hived off to Kaytee Switchgear Private Limited:

- (i) Extra large and large AC Motors/Generators (Unit I) at new location near Bangalore;

- (ii) Medium and Small AC Motors/Generators (Unit II) at Hubli;
- (iii) D.C. Machines and Traction (Unit III) at new location near Bangalore;
- (iv) Component unit (Unit VII) at Tumkur;
- (v) Spares Division (Unit XXII) at Bangalore; and
- (vi) Renewable Energy Group (REG) at existing locations.

The "Special Purpose Vehicle" (SPV) means an entity to which the non-manufacturing surplus assets and real estate of KECL will be transferred for liquidating/repayment of secured creditors liabilities and statutory and other dues of KECL, Best Trading and Agencies Limited (BTAL), a subsidiary company of KECL incorporated under the Companies Act, 1956, is the entity identified for the purpose.

In Part III of the scheme, it is stated:

"2. It has been mutually agreed between the company and KSPL (RMG) that all the brand/s/trademark/s, the registered trade-mark/s and benefits of permitted user agreements of KECL shall be available to KSPL for manufacture of products being currently manufactured by the company so long as KECL holds not less than 51% of the paid up equity capital of KSPL. The present covenant shall serve as requisite consent for use of the brand name/trademark without requiring the execution of any further deed or document as to assignment and permitted user of the said brand name/trademark, subject, however to approval of instant scheme of arrangement by the Hon"ble Court.

8. RMG undertakes to engage on and from the effective date all permanent employees of KECL engaged in its RMG on the same terms and conditions on which they are employed as on the effective date by KECL without any interruption of services as a result of the transfer. RMG agrees that the services of all such employees with KECL upto the effective date shall be taken into account for purposes of all retirement benefits including retrenchment compensation to which they may be eligible in KECL on the effective date. However, such of the employees who would not accept the transfer and those who are found surplus will accept voluntary retirement as per the rules of the company".

18. A bare perusal of the scheme would indicate that major portion of the assets of the transferor company shall be transferred to the transferee companies and so also the liabilities. It is also mentioned therein that all the employees of the transferor company shall become the employees of the transferee companies on the same terms and conditions on which they have been working with the transferor company.

19. Prima facie to me it appears that the main and real purport of the scheme appears to be to transfer the primary and valuable assets of the company including the entire movable properties of the company to the transferee

companies which are just paper companies without paying the proper stamp duty and for me it also appears the same is not in public interest. I say so on the basis of the latest audited balance-sheets produced by the transferee companies on the directions issued by this Court. On these aspects, I would advert, if it is necessary, after answering the primary issue namely, whether in law the present scheme of arrangement could be sanctioned without the request of the transferee companies by filing appropriate petitions before this Court and if it is must, it would be pointless in sanctioning the scheme, which cannot be carried in effect in the absence of an appropriate request made by the transferee companies by filing appropriate petitions as required under the provisions of Sections 391 to 394 of the Companies Act.

20. This is one question, which I repeatedly asked the learned Counsel for the petitioner to clarify at the time of hearing of the petition. Initially there was no answer and thereafter whatever answers were given was vague enough, which would not fit into the scheme of Sections 391 to 394 of the Act. May be knowing the obvious result of this petition, the learned Counsel has thought it fit to file two separate applications for and on behalf of the transferee companies under Rule 9 of the Companies (Court) Rules, with a request to dispense with convening of the meetings of the shareholders and creditors of the transferee companies. In the synopsis of the submissions of the petitioner-company, the learned Counsel for petitioner-company admits, may be with some reservation that there is a requirement under the Act for the transferee companies to file separate petition as envisaged under Sections 391 to 394 of the Act but that legal requirement is satisfied by filing affidavits of shareholders, which confirm the position that the transferee companies have taken the consent, both of the Board of Directors as well as individual shareholders. The submission made in that regard is as under:

"(3) Transfer of assets in favour of K.T. Switch Gear Private Limited and Best Trading and Agencies Limited.-The scheme of restructuring envisages transfer of certain assets and liabilities to these two companies. The objection raised is that these companies are not parties to the petition and that while there can be no legal objection to the company taking over of the assets, there must be the consent of the company for the discharge of liabilities. With a view to avoiding any further technical difficulties, when this matter was raised by this Hon'ble Court, it was submitted by the petitioner that it would take necessary steps to comply with the requirement of the presence of these two companies in the petition and also place material to affirm that they had accepted the necessary obligations in regard to the liabilities under the scheme. Both these two companies had earlier filed affidavits to affirm that in terms of the Board's resolution already passed, they were willing to take over both the assets and liabilities. These affidavits were filed on 29-8-2002. In order to further strengthen the obligations of these companies in the above proceedings before this Hon'ble Court, they have now also filed applications on 3-10-2002 for being brought on record and also affirming their acceptance to take over the assets as

well as the liabilities supported by individual affidavits of its shareholders which now legally confirms the position that these two companies have taken the consent, both of the Board of Directors as well as of all the individual shareholders. Reference to this will be made at the time of hearing".

21. The applications were heard along with the main petitions. The answer to the prayers made in these applications, I will give it a little later.

22. Before I answer the primary question which I have raised for considering the prayer made in the company petition, let me just notice the net worth of the transferee companies and also who are their members and creditors. M/s. Kaytee Switch Gear Private Limited is one of the transferee companies under the scheme of arrangement. This company was incorporated under the provisions of the Companies Act on 2nd March, 1983, with the authorised share capital of Rs. 3 crores. The subscribed capital of the company is Rs. 2,000 divided into 200 equity shares of Rs. 10/- each. The subscribed capital is held by two shareholders namely, Sri Vijay R. Kirloskar and Sri P.S. Malik, who are none other than the Chairman and Managing Director and Deputy Managing Director of the petitioner-company respectively. In the affidavit filed along with its application for dispensing with the convening of the meetings of the shareholders and creditors of the company, it is stated that it does not have any creditors as on 1-10-2002 and in its Board meeting held on 4th March, 2002, it has examined the scheme of arrangement presented by the petitioner-company and the applicant company, its Directors and shareholders have agreed to accept the terms of the scheme of restructuring and to discharge their obligations in regard to the liabilities imposed upon the applicant company in terms of the said scheme and any further consent of the company, its Directors and shareholders would indeed be unnecessary at this stage as the said legal requirement is fulfilled in spirit and therefore they request this Court to dispense with the convening of the meetings of the shareholders of the applicant company for the purpose of approving the scheme.

23. M/s. Best Trading and Agencies Limited is another transferee company, which was incorporated on 2nd May, 1988 with an authorised capital of Rs. 1 crore. The subscribed capital is Rs. 1,000 divided into 100 equity shares of Rs. 10/- each and the same is held by the shareholders namely, Kirloskar Electric Company Limited, which is the petitioner-company, Sri Vijay R. Kirloskar, Sri Shankaranarayana Rao and Sri P.S. Malik, the Chairman and Managing Director, Director (Legal and Corporate Matters) and Deputy Managing Director of Kirloskar Electric Company Limited respectively. Even this company has filed similar application as has been done by the other transferee company.

24. Initially the scheme requires to be examined from the standpoint of legal formalities that ought to be completed before the Court proceeds to examine the same on merits. It is now well-settled by several decisions of the Courts that before the Court sanctions a scheme, it will normally need to be satisfied on three points:

I. Whether the statutory provisions have been complied with?

II. Whether the class or classes affected by the scheme have been fairly represented?

III. Whether the arrangement is such as a man of business would reasonably approve?

25. Applying the first test, whether the statutory provisions have been complied with, it must be noticed that except for some contentions taken on behalf of Regional Director, no one has raised any contention about the formalities which must precede the stage, when the Court sanctions the scheme, I will deal with the case put forth by Regional Director.

26. The Regional Director in his counter-affidavit has taken a contention that as per the scheme of the divisions/undertakings, the petitioner-company will be de-merged/hived off and transferred in favour of M/s. Kaytee Switch Gear Private Limited and M/s. Best Trading and Agencies Limited and those transferee companies have not filed any petition before this Court under Sections 391 to 394 of the Act and in the absence of such a petition, it may not be permissible for this Court to sanction the scheme of arrangement which would bind the transferee companies.

27. The essential feature of the scheme of arrangement is a contract between two parties. In Section 391 of the Act, the expression "compromise and arrangement" both are used by the Legislature intentionally and consciously. However, the expression "arrangement" used in the section means something analogous in some sense to a compromise. Any arrangement, which can be fairly called a compromise or considered as analogous to compromise, there must be both give and take. In the Halsbury's Laws of England, the meaning of the expression "reconstruction and amalgamation" is explained. The same is as under; "Neither "Reconstruction" nor "Amalgamation" has a precise legal meaning.

Where an undertaking is being carried on by a company and is in substance transferred, not to an outsider, but to another company consisting substantially of the same shareholders with a view to its being continued by the transferee company, there is a reconstruction. It is none the less a reconstruction because all the assets do not pass to the new company, or all the shareholders of the transferor company are not shareholders in the transferee company, or the liabilities of the transferor company are not taken over by the transferee company". The arrangement now proposed does all the giving. To arrive at this conclusion, I have carefully analysed the scheme and it is only for that purpose, I have reproduced in extenso some material clauses in the scheme of arrangement. An analysis of the scheme of arrangement would definitely demonstrate that under the scheme, the assets and liabilities of the transferor company will be transferred to M/s. Kaytee Switch Gear Private Limited and M/s. Best Trading and Agencies Limited, without those companies presenting any

petition before this Court as required under Sections 391 to 394 of the Act, so that if this Court sanctions the scheme it would not only bind the company but also its shareholders and creditors.

28. To carry out steps taken by the sponsor, before reaching the present stage of examining the scheme on merits, it may be stated that appropriate judge summons was taken out in C.A. No. 134 of 2002 requesting this Court to convene a meeting of the shareholders, secured and unsecured creditors. Before the meetings were convened, the Chairman appointed by this Court to hold such meetings had issued individual notices to the members and creditors of the company and annexed to the notice, the whole scheme as proposed by the sponsor and explanatory statement as required u/s 393 of the Act was also enclosed. The report submitted by the Chairman gives a picture indicating what transpired at such meetings. After complying with the formalities, the present petition is filed under Sections 391(2) and 394 of the Act, with a request to sanction the scheme of arrangement as approved by members and creditors of the company. On presentation of such petition, the Court had ordered for issue of notice on the Regional Director, which is a prerequisite at the stage of sanction of the scheme.

29. Now the question would be whether similar requirement is necessary qua the shareholders of the transferee companies?

30. The provisions of Section 391 of the Act provides for compromise or to make arrangements with creditors and members. Sub-section (1) of Section 391 of the Act obligates that the company or a creditor or any member of the company in the case of the company which is alive, and official liquidator in the case of a company which is wound up, must obtain directions for convening of meeting in case of proposed scheme of a compromise between a company and its creditors or any class of them or between a company and its members or any class of them by making an application before the Court and if approved at the meeting, have it sanctioned by filing a petition under Sections 391(2) and 394 of the Act and that would be binding on all the creditors or all the creditors of the class, all the members or all the members of the class, and also on the company, in the case of the company, which is being wound up, on the liquidator and contributories of the company.

Proviso appended to the section gives a wide discretion to the Court, while sanctioning any compromise or scheme of arrangement. Before granting the prayer made in the petition filed under Sections 391(2) and 394 of the Act. the Court must be satisfied that the company or any other person by whom the application is made under Sub-section (1) has disclosed to the Court by affidavit or otherwise all the material facts relating to the company, the latest financial position of the company, the latest auditors report on the accounts of the company, the pendency of any investigation proceedings in relation to the company under Sections 235 to 25 and the like.

Section 392 of the Act provides ample powers to the Court to enforce compromise and arrangement.

Section 393 of the Act mandates that whenever a meeting of creditors or any class of creditors or of members or any class of members is called u/s 391 of the Act by issuing a notice, it should contain statement setting forth the terms of the compromise or arrangement and explaining its effect.

Section 394 of the Act provides:

"(1) Where an application is made to the Court u/s 391 for the sanctioning of a compromise or arrangement proposed between a company and any such persons as are mentioned in that section, and it is shown to the Court:

(a) that the compromise or arrangement has been proposed for the purposes of, or in connection with, a scheme for the reconstruction of any company or companies, or the amalgamation of any two or more companies".

Clause (b) of Section 394 enables the company to make provision inter alia providing for the following matters:

"(i) the transfer to the transferee company of the whole or any part of the undertaking, property or liabilities of any transferor company;

(ii) the allotment or appropriation by the transferee company of any shares, debentures, policies, or other like interests in that company which, under the compromise or arrangement, are to be allotted or appropriated by that company to or for any person;

(iii) the continuation by or against the transferee company of any legal proceedings pending by or against any transferor company;

(iv) the dissolution, without winding up of any transferor company".

Sub-clauses (i) and (ii) of Clause (b) of Section 394 of the Act are referable to the transferor company only. Hence, in an application made "under Section 394 of the Act, the Court will be in a position to make effective orders as provided under Sub-clauses (i) and (ii) on the matters enumerated therein which would be binding on the transferor company, its members and creditors.

Sub-clauses (ii) and (iii) of Clause (b) of Section 394 of the Act are referable only to transferee company. The Court cannot bind them to do things enumerated under the aforesaid clauses unless they are before this Court by filing firstly, an application u/s 391 of the Act inter alia seeking a direction to convene the meeting of the members and creditors of the company. In the said application, the company may also request the Court to dispense with the holdings of the meetings of the member and creditors of the applicant company for the reasons mentioned therein. After complying with those formalities, the transferee company may present a petition inter alia seeking an approval of the resolutions passed in the Board of Director meeting. On presentation of such a petition, the

Court shall issue a notice u/s 394-A of the Act to the Regional Director, Department of Company Affairs, Chennai, who is the delegatee of the Central Government and take into consideration the representation made by the Regional Director before passing any order on the proposed scheme of arrangement or compromise. The object and purpose of introducing the aforesaid mandatory provision has been explained by Madras High Court In the matter of UCAL Fuel Systems Limited and Anr.:

"Section 394-A of the Act makes it obligatory on the Court to give notice to the Central Government of every application made to it u/s 391 or Section 394 and to take into consideration the representations made by that Government before passing any order on the proposed scheme of amalgamation. This would enable the Central Government to study the proposal and raise objections thereto as it thinks fit in the light of the facts and information available with, it, and also place the Court in possession of certain facts which might not have been disclosed by those who appear before it so that the interests of the investing public at large may be fully taken into account by the Court before passing its order. The powers and functions of the Central Government under this section have been delegated to the Regional Directors who are to exercise the same, subject to the control of the Company Law Board (Notification No. GSR 416, dated 22nd February, 1969)".

31. In view of the above, it can safely be said that both the transferor and transferee companies should make either a joint petition or separate petition as envisaged u/s 394 of the Act. Sub-clause (v) of the section is equally applicable to the transferor and the transferee companies, for it cannot be the position that it is only the shareholders of the

1. (1992) 73 Comp. Cas. 63 (Mad.) transferor company, who can dissent. The general powers contained in Sub-clause (vi) may require application both in the case of transferor company and the transferee company. If an arrangement is sanctioned and directions are given under Sub-clauses (i) and (ii) of Section 394 of the Act, on a petition filed by the transferor company, then the orders so made by the Court may not bind the transferee company, its members and creditors and the same would lead to incongruous situation. In my view, the various sub-clauses of Section 394 of the Act, confirms the view that both the transferor and the transferee company should make an application under Sections 391 to 394 of the Act before the scheme of arrangement is sanctioned. Therefore, mere filing of application under Rule 9 of the Companies (Court) Rules by the transferee companies would not satisfy the requirement under Sections 391 to 394 of the Act. Therefore, in my opinion, each of the companies for the scheme of arrangement must comply with the requirements of Section 391(1) of the Act by obtaining directions, inter alia for holding the meeting of the shareholders and creditors of the companies.

32. To sum up, this petition is only by the transferor company and the prayer made in the petition is to sanction the scheme of arrangement so as to be binding on all the members, secured creditors, unsecured creditors of the

petitioner-company, as well as on the petitioner-company and that by true construction of Sections 391 to 394 of the Companies Act, the transferee company should also join in this petition and there should be meeting of the shareholders of the transferee company after obtaining directions from this Court for convening the meeting as well as approving the scheme of arrangement. Since the assets and liabilities of the petitioner-company will be transferred to the transferee companies under the scheme of arrangement, the shareholdings and other rights of the transferee companies would be affected and it is going to change the capital structure of the transferee companies.

33. In view of the above, I am of the view that the transferee companies should comply with the statutory requirements as envisaged under Sections 391 to 394 of the Act and otherwise any directions issued by this Court would not bind the transferee companies, its members or creditors and any order that is made on the petition filed by the transferor company would only bind the transferor company, its members and creditors and since that is not the object of the scheme of arrangement, the prayer made in the company petition filed by transferor company even if it is granted would not serve the purpose for which the transferor company is before this Court and such an order would not be beneficial to the transferor company in any manner whatsoever and it would be pointless even if the request made in the petition filed by the transferor company is sanctioned.

34. In the result, petition fails and accordingly, it is rejected. No order as to costs. Ordered accordingly.