
(1988) 03 AP CK 0022

In the Andhra Pradesh High Court

Case No : Company Petition No. 12 of 1987

Lalchand Surana and Others

APPELLANT

Vs

Hyderabad Vanaspathy Ltd.

RESPONDENT

Date of Decision : 11-03-1988

Acts Referred:

Companies Act, 1956 — Section 433, 80(1), 85

Citation : (1990) 68 CompCas 415

Hon'ble Judges : B.P. Jeevan Reddy, J

Bench : Single Bench

Advocate : T. Anantha Babu, for the Appellant; M.R.K. Chowdary, for the Respondent

Judgement

Jeevan Reddy, J.—This petition is filed by three shareholders of Hyderabad Vanaspathy Ltd., a public limited company, having its registered office at Hyderabad, for winding up the company on the ground that it is unable to pay its debts, within the meaning of clause (e) of section 433 of the Companies Act, 1956. The respondent-company has raised an objection as to the maintainability of the petition.

2. The petitioners say that the respondent-company was incorporated in June, 1970. The share capital of the company is Rs. 50 lakhs, divided into 10,000 cumulative redeemable preference shares of Rs. 100 each, and 4,00,000 equity shares of Rs. 10 each. The three petitioners hold 1,000, 1,800 and 2,200 redeemable cumulative preference shares, respectively, of a total value of Rs. 5 lakhs. These shares, carrying a dividend of 9.5% were issued on January 7, 1971, and were redeemable at par after 15 years from the date of allotment. The date of allotment is February 8, 1971. When the petitioners asked for redemption of the shares, the board of directors, instead of redeeming the same, decided to postpone the payment the payment for five years. They convened a general body meeting on March 29, 1986, whereat a special resolution was passed by the equity shareholders extending the period of redemption of redeemable

cumulative shares by the five years. A letter was addressed to the preference shareholders requesting them to agree to the said extension, which they refused. Ultimately, the petitioners, gave a legal notice dated November 19, 1986, calling upon the company to pay the amounts due, which the company has failed to comply with. The balance-sheet of the company shows that its financial position is not happy; it has been incurring losses; it has leased out its factory since 1977; losses are steadily amounting; no audit is being done and no effect are being made to revive the company. It is submitted that the petitioners are in the nature of "creditors" and hence entitled to ask for the winding up of the company u/s 433(e) of the Act. The petition is filed u/s 433(e), 434(1)(a) and 439(1)(b) of the Act.

3. A counter-affidavit has been filed on behalf of the company denying the various allegations made in the petition. It is submitted that the petitioner being shareholders cannot style themselves as "creditors" and have, therefore, no locus standi to maintain the petition. It is submitted that the petitioners hold only a one-third shareholding interest, and cannot justly ask for winding up of the company. The allegations with respect to negative financial position and other defaults are denied.

4. The first question that has to be answered is whether the petitioners being preference shareholders can call themselves "creditors" and ask for winding up of the company u/s 433(e) read with section 434(1) and section 439(1)(b) of the Act. Ordinarily speaking, shareholders are not creditors. But, the contention of Mr. T. Anantha Babu, learned counsel for the petitioners, is that the petitioners are holding preference shares which are redeemable 15 years after the date of allotment. These shares carry a fixed dividend of 9.5%. When the petitioner called upon the company to pay the amount due on the said share, the company was unable to pay, which means that the said amount has become due. The petitioners have thus become "creditors" and the company has become a "debtor" vis-a-vis the petitioners.

5. On the other hand, it is contended by Sri V. Rajagopal Reddy, learned counsel for the respondent-company, that preference shareholders are also shareholders, and by no stretch of imagination can they become creditors. It is pointed out that, according to section 80 of the Act, preference shares shall be redeemed only out of the profits of the company which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares, made for the purposes of redemption, and that this circumstance clearly shows that preference shareholders - even though the shares held by them are redeemable after the fixed period - do not assume the character of "creditors", and hence they cannot sue for the winding up of the company as company as creditors.

6. Section 85 of the Act says that share capital is of two kinds, viz., preference share capital and equity share capital. Sub-section (1) of section 85 defines "preference share capital" in the following words :

"Preference share capital" means, with reference to any company limited by shares, whether formed before or after the commencement of this Act, that part of the share capital of the company which fulfils both the following requirements, namely :-

(a) that as respects dividends, it carries or will carry a preferential right to be a fixed amount or an amount calculated at a fixed rate, which may be either free of or subject to Income Tax; and

(b) that as respects capital, it carries or will carry, on a winding - up or repayment of capital, a preferential right to be repaid the amount of the capital paid up or deemed to have been paid up, whether or not there is a preferential right to the payment of either or both of the following amounts, namely :-

(i) any money remaining unpaid, in respect of the amounts specified in the clause (a), up to the date of the winding up or repayment of capital; and

(ii) any fixed premium or premium on any fixed scale, specified in the memorandum or articles of the company."

7. It is not necessary for the present purpose to notice the Explanation to sub-section (1). In this case, the memorandum or articles of association do not expressly say that these preference shares will carry a preferential right to be paid a fixed amount towards dividends. Nor do they say that, on winding up of the company, these shares shall be entitled to a preferential right to be repaid the amount of paid-up capital. Indeed, they purport to be redeemable preference shares which means that, after the specified period of 15 years, the amount due thereunder, along with, the accumulated dividend, becomes payable. In this sense, they do not strictly fall within the meaning of "preference shares" as defined in section 85(1). But, in view of the pleadings before me, it is not permissible for me to go into the question, whether they are preference shares at all, or whether, in truth and reality, their character is different, though called "preference shares". Both the parties have proceeded on the assumption that they are preference shares, validly issued by the company. The only question is whether, in case of failure of the company to repay the amount due thereunder, such shareholders become "creditors". It is in this context that proviso (a) to sub-section (1) of section 80 becomes relevant. Sub-section (1) of section 80 says that subject to the said section, a company limited by shares may, if so authorised by its articles, issue (i) preference shares which are to be redeemed, or (ii) preference shares which are liable to be redeemed at the option of the company. Proviso (a), however, says that no such shares shall be redeemed except out of the profits of the company, which would otherwise be available for dividend, or out of the proceeds of a fresh issue of shares made for the purpose of the redemption. This aspect, in my opinion, shows that where redeemable preference shares are issued but not honoured when they are ripe for redemption, the holder of those shares does not automatically assume the character of a "creditor". The reason is that his shares can be redeemed only out

of the profits of the company which would otherwise be available for dividend, or by afresh issue of shares. This is a limitation which is not applicable to the case of an ordinary creditor. In the face of this position in law, and in the absence of any authority on the subject, I hold that the holders of redeemable preference shares do not and cannot become creditors of the company in case their shares are not redeemable by the company at the appropriate time. They continue to be shareholders, no doubt subject to certain preferential rights mentioned in section 85. If they do not become the creditors of the company, they cannot apply for winding up of the company u/s 433(e).

8. In *Globe United Engineering and Foundry Co., Ltd. Vs. Industrial Financial Corporation of India and Others*, , there is a good amount of discussion about the nature of preference shares; but, the question with which I am faced, did not arise, nor was it discussed therein. That was a case where the question was whether, in spite of the company not commencing business, not making any profits, and there having been nothing to declare by way of dividend, the preference shareholders of the company are entitled to arrears of cumulative dividend at the prescribed rates as per the article of association, in priority to the ordinary shareholders. It was held, that a provision shareholders viding for such a preference is valid, and that the preference shareholders are entitled to priority in the matter of repayment of capital over the equiry shareholders, in the course of winding up of the company. In the course of discussion, the learned judge observed thus (at page 356) :-

"The outside investor may be induced to subscribe for preference rather than ordinary shares by reason of the bargain offered; such investor has usually little knowledge of the company's business, has no wish to participate in the company's management and is keen only on his promised return. IT may also happen that if the companies want to raise new capital when their existing shares are worth less than the nominal value the only direct way of raising new capital, apart from borrowings and debentures, will be to issue a new class of shares with preferential rights over the existing ones. The preference shares are really part of the company's share capital; they are not loans.

9. Relying upon the last sentence in the above extract, Mr. V. Rajagopal Reddy contends that preference shares are really part of the company's share capital, and that they are not, and do not become loans, in any case.

10. Mr. Rajagopal Reddy also relies upon an unreported decision of Ramanujulu Naidu J. in Company Petition No. 28 of 1986, disposed of on February 11, 1987. On perusing the said decision, however, I do not find that the question now arising before me was either considered or pronounced upon in the said judgment. It is, therefore, unnecessary for me to refer to the said judgment in any detail.

11. Having regard to the opinion expressed hereinabove, the petition must be held to be not maintainable in law.

12. The company petition is, accordingly, dismissed. There shall be no order as to costs.