
(1986) 08 BOM CK 0020

In the Bombay High Court

Case No : Notice of Motion No. 1365 of 1986 in Suit No. 1521 of 1986

Narotamdas Trikamdas Toprani

APPELLANT

Vs

Bombay Dyeing and Manufacturing Co. Ltd. and others

RESPONDENT

Date of Decision : 22-08-1986

Acts Referred:

Companies Act, 1956 — Section 118, 163(2), 209(4), 209A, 439

Citation : (1986) 88 BOMLR 649 : (1990) 68 CompCas 300

Hon'ble Judges : Sujata V. Manohar, J

Bench : Single Bench

Judgement

1. The plaintiff is a debenture-holder in the Bombay Dyeing and Mfg Co. Ltd., the first defendant herein. He has filed the present suit on behalf of himself and other debenture-holders of the first and third series of debentures for a declaration that the first defendant company is not entitled to issue the proposed debentures pursuant to a letter of offer dated May 5, 1986, ranking pari passu with the debentures of the first, second and third series of debentures already issued by the first defendant company, and is not entitled to secure the said issue by a first mortgage on the fixed assets of the first defendant company. The plaintiff has prayed that the first defendant company should be permanently restrained from issuing any debentures pursuant to the letter of offer dated May 5, 1986. He has also prayed that the first defendant company should be ordered to repay all application monies received by the first defendant company in respect of the proposed new debenture issue. The plaintiff has sought various other reliefs as set out in the plaint.

2. The present notice of motion is taken out by the plaintiff for an injunction to restrain the first defendant company from directly or indirectly using the application monies received so far pursuant to the letter of offer dated May 5, 1986, and to restrain the first defendant company from allotting and/or issuing the new debentures pursuant to this letter of offer. The notice of motion also prays that the first defendant company should be restrained from creating any

mortgage and/or charge on the fixed assets of the first defendant company as set out therein.

3. The plaintiff holds 17 debentures of the value of Rs. 100 each in the first series of debentures which were issued by the first defendant company in August, 1979. He also holds nine debentures of Rs. 100 each in the third series of debentures which were issued in February, 1983. He has filed the present suit under Order 1, rule 8 of the CPC on behalf of all the debenture-holders in the first and third series issued by the first defendant company.

4. It has been submitted by the first defendant company that the suit itself is not maintainable since the plaintiff has no locus standi to maintain this suit. Hence, no relief can be granted to the plaintiff on the present notice of motion. According to the first defendant company, a suit claiming relief of the kind prayed for can only be maintained by the trustees of the debenture trust deeds in question since the suit is essentially to preserve the securities and enforce covenants given by the first defendant company to the trustees.

5. In order to appreciate this contention, it is necessary to examine the terms of the relevant debenture trust deeds, letters of offer and debenture certificates.

6. The first series of debentures were initially issued by the first defendant company in the year 1965. These debentures which were to the extent of Rs. 2.50 crores were secured by a debenture trust deed dated June 2, 1965, which was executed by the first defendant company in favour of the trustees of the said debentures.

7. Under the debenture trust deed June 2, 1965, clause 3 deals with the powers of the company to issue further pari passu debentures. Clauses 4 and 6 contain covenants by the company with the trustees that the company will pay to the holders of debentures the amount secured by the debentures and interest thereon as set out in the said clauses. As a security for repayment of these amounts, the company under clauses 7, 8, 9, 10 and 11 has created a mortgage in favour of the trustees of various properties of the company as set out in those clauses and has also created a floating charge on the general assets of the first defendant company. Under clause 55 of the debenture trust deed, "the debenture-holders shall in general meeting have", inter alia, "the powers to sanction any modification of the rights of the debenture-holders against the company or against its property whether such rights shall arise under these presents or otherwise". Under clause 56, the trustees may, from time to time, and at any time whenever they think fit or expedient in the interest of the debenture-holders, waive, on such terms and conditions as shall deem expedient to them, any breach by the company of any of the covenants contained in the said trust deed. Under clause 66, the trustees shall not be liable for any default or omission or delay in performing or exercising any of the powers of trusts contained in the said deed of trust unless the trustees shall have been previously, by notice in writing, requested to exercise such powers, trusts or acts by the

holder of at least one-half of the debentures for the time being outstanding. The clause further provides that the trustees shall not be bound to exercise such powers until sufficient moneys have been provided by the debenture-holders for any costs or expenses which the trustees may incur.

8. Under the said deed of trust, the trustees have been given various powers which pertain to taking possession of mortgaged security or to have a receiver appointed for the protection of the said security under various circumstances which are set out in the trust deed.

9. Debentures which were initially issued under the said debenture trust deed were, thereafter, reissued in 1979, and were secured under the provisions of a supplemental deed of trust dated August 9, 1979. Under the supplemental deed of trust dated August 9, 1979, the original terms of the debenture trust deed of June 2, 1965, were continued with certain modifications. The modification most relevant for the purpose of the present notice of motion is contained in the modified clause 3 of the said supplemental trust deed. Under the new clause 3 of the said supplemental trust deed, the company has given certain covenants. These are as follows :

"... (b) The company hereby covenants with the trustees that during the continuance of this security, the company shall maintain a margin of 40% (forty per cent.) or such lower margin as the trustees may agree, on the security comprising the net (depreciated) book value of the then existing fixed assets (excluding motor cars, vehicles, furniture and fixtures, goodwill, patents, etc.) of the company and the company doth hereby agree and undertake that in case, for any reason, such net (depreciated) fixed assets cover falls below 40% or such lower margin as may be agreed by the trustees, the aggregate nominal amount of Rs. 2,50,00,000 (rupees two crores and fifty lakhs) of the outstanding debentures, the outstanding amounts of the ICICI foreign currency loans, and the outstanding amounts of GBL deferred payment guarantees, the company shall give an additional cover acceptable to the trustees to the extent of such shortfall falling which the company shall forthwith redeem the debentures the nominal amounts of which are in excess of the aggregate of the nominal amount of debentures outstanding together with outstanding amounts of the ICICI foreign currency loans and the outstanding amounts of GBL deferred payment guarantees cover 60% of the net (depreciated) book value of its fixed assets (or such lower margin as may be agreed to by the trustees) then comprised in the security hereunder and to satisfy the trustees that the requisite coverage was available, the company shall furnish to the trustees twice a year within one month from the dates hereinafter specified, audited statements showing as on the 31st day of March of each year the net (depreciated) value of such assets and additions to the assets as on the 31st day of March of each year, available as and by way of security as aforesaid.

(c) During the continuance of this security, the company will be entitled to make a further issue of debentures including the said further debentures of Rs.

1,00,00,000 (rupees one crore) and/or raise further loans ranking pari passu with the existing debentures issued by the company : provided that :-

(i) the net aggregate written down value of the fixed assets of the company forming part of the mortgage security hereunder shall be at least 166% of the value of the debentures issued and outstanding and any such further issue of debentures and the outstanding debentures/ICICI foreign currency loan/GBL deferred payment guarantee ranking pari passu secured by the aforesaid mortgaged premises.

(ii) the average profit of the company after charging interest on loans for working capital and all expenses of working and management including maintenance and repairs but before charging interest on outstanding debentures/ICICI foreign currency loans/GBL deferred payment guarantees, depreciation, development rebate, reserve and taxes for the three accounting years for which accounts have been audited last preceding the date of any such further, issue, and sufficient to cover at least twice the amount required to pay the aggregate of one year's interest on the amount of outstanding existing debentures and ICICI foreign currency loans and GBL deferred payment guarantees and on the amount of additional debentures proposed to be issued;

(iii) such further issue of debentures/raising of further loans is made by special resolution of the debenture-holders passed in accordance with the provisions of the seventh schedule hereunder written."

10. Under clauses 16 and 17 of the seventh schedule (original sixth schedule in the debenture trust deed of June 29, 1965), a special resolution passed at a general meeting of debenture-holders is binding on all debenture-holders whether present at the meeting or not. A special resolution requires to be passed by a three-fourths majority of debenture-holders present and voting.

11. Thereafter, under a second supplemental debenture trust deed dated August 28, 1980, further debentures of the aggregate nominal value of Rs. 1,00,00,000 were issued to rank pari passu with the debentures already issued and outstanding. Under clause 3 of the second supplemental debenture trust deed dated August 28, 1980, also, it is provided that these debentures are issued pursuant to clause 3 of the principal deed which was amended as per supplement trust deed August 9, 1979.

12. Thus, the first series of debenture-holders are beneficiaries of covenants which the first defendant company has given to the trustees of the said series, as a result of which the first defendant company is required to maintain a margin of 40% (or a lower margin as the trustees may agree upon) on the security comprising the net book value of the then existing fixed assets of the first defendant company as set out in the said clause 3. There is also a further covenant between the company and the trustees that the company, if it makes a further issue of debentures which rank pari passu with the existing issue, will maintain this margin of fixed assets in relation to the value of debentures issued

and outstanding, certain other loans which are also secured by a pari passu mortgage of the said securities and such further issue of debentures (hereinafter referred to as "the fixed assets cover"). The company has also covenanted with the trustees to maintain the ratio of profits to interest required to be paid on such debentures in the proportion of 2:1. The quantum of profits and of interest is to be calculated as set out in the said clause 3. (This is hereinafter referred to as "the profits cover").

13. The debenture certificates which have been issued are in forms which are annexed to these debenture trust deeds. The debenture certificates state that the first defendant company will on the dates specified therein pay to the registered holders on presentation of such certificates the amount set out therein. The certificates also state that the company will, during the continuance of security, pay to the registered holders interest as set out therein. The certificates further state that "the debenture is issued subject to the provisions of the above-mentioned trust securities whereby all remedies for the recovery of the principal monies and interest secured by the debentures are vested in the trustees on behalf of the debenture holders and it is accordingly expressly stipulated that the debenture shall operate only according to the tenor thereof."

14. The third series of debentures which rank pari passu, inter alia, with the first series of debentures are issued pursuant to the letter of offer dated February 28, 1983. They are secured by a debenture trust deed dated January 15, 1985, as a result of which the first defendant company has created certain securities in favour of the trustees of the third series of debentures on terms and conditions which are set out in the said debenture deed. Under clause 3.4 of the said debenture trust deed, it is provided as follows :

"3.4 During the subsistence of the debentures and during the period the security in favour of the agent and trustees subsists, if the company makes a further issue of debentures and/or raises further term loans its fixed assets ranking on pari passu basis with the debentures, the company shall comply with the following conditions :

(i) the net aggregate written down value of the fixed assets of the company forming part of the mortgaged assets for the debentures shall be one and a half times the value or such lesser value as may be agreed to by the agent and trustees of the debentures issued and outstanding and the outstanding term loans, deferred payment liabilities/guarantee facilities and any such further debentures and the terms loans and deferred payment facilities/guarantee facilities secured on pari passu basis the mortgaged assets;

(ii) the average of profits of the company after charging interest on loans for working capital and all expenses of working and management including maintenance and repairs but before charging interest on term loans/deferred payment guarantees/guarantee facilities, depreciation, development rebate, investment allowance, resources and taxes for the three according years for

which accounts have been audited last preceding the date of any such further issue or raising of term loans or availing of deferred payment guarantee facilities sufficient to cover as far as possible, at least twice the amount required to pay the aggregate of one year's interest on the amount of the debentures issued and outstanding and the outstanding term loans, deferred payment or guarantee facilities on the amount of further debentures, term loans, deferred payment guarantee facilities;

(iii) such further issue of debentures, raising of further loans and/or deferred payment or guarantee facilities are sanctioned by a special resolution of the holders of the debentures passed in accordance with the provisions contained in the regulations for a meeting of the holders of the debentures, as provided in annexure "D" to the Companies (Central Government) General Rules and Forms, 1965, as amended and prevailing from time to time."

15. Debenture certificates which are issued under this debenture trust deed are substantially in the same form as the earlier debenture certificates.

16. It is contention of the first defendant company that the covenants under these various debenture trust deeds which require the first defendant company to maintain a certain between its fixed assets and the value of debentures as also between its profits and interest to be paid on these debentures, are covenants which are entered into between the first defendant company and the trustees. There are no such covenants between the company and any of the debenture-holders. The first defendant company, therefore, contends that a debenture-holders by himself or on behalf of the entire class of debenture-holders cannot maintain the present action which is an action for enforcement of these covenants.

17. Now, the rights of a debenture-holder and the obligations which the company has towards its debenture-holders, depend essentially upon the terms of the agreement between the company and its debenture-holders as also between the company and the trustees of such debentures. A debenture-holder can sue the company for the recovery of amounts payable to him as the holder of the debenture certificates because the debenture certificate, as in the present case usually contains a covenant directly between the company and the debenture-holder that the company will pay the said amount and interest thereon to the debenture-holder. However, where there is no such direct covenant between the company and the debenture-holder, it has been held that the debenture-holder cannot maintain such an action. Thus, in *Uruguay Central and Hygueritas Railway Co. of Monte Video, In re* [1879] 11 Ch 372, the company had issued bonds or debentures and had created a debenture stock. There was no direct covenant between the company and the debenture stock-holders for payment of any amount to the stock-holders. The covenant was between the company and the trustees for payment of the amounts. The court held that in view of the terms of the deed, the holders of bonds were not creditors of the company; they were merely *cestui que trust* of a charge, having a right, no doubt, to put their

trustees in motion to compel payment under the covenant, but not having any independent right to sue the company either at law or in equity.

18. Similarly, in *Dunderland Iron Ore Co. Ltd.*, In re [1909] 1 Ch 446, a trust deed for securing debenture stock made between the company and the trustees for the stock-holders, provided that the company would pay the interest to the stock-holders. But the certificate delivered to each stock-holder did not contain any direct covenant with the stock-holder to pay him interest. It was held that stock-holders whose interest was in arrears were not entitled to present a winding-up petition as creditors u/s 82 of the English Companies Act, 1862.

19. In both these cases, a debenture-holder was held not to be a creditor of the company on the basis of covenants contained in the debenture certificate which was issued to him by the company. There are a number of cases, however, where English courts have construed the debenture-holder as a creditor of the company wherever there has been such a direct covenant between the company and the debenture-holder. Thus, for example, in *Olathe Silver Mining Co.*, In re [1884] 27 Ch 278, the earlier decision in *Uruguay Central and Hygueritas Railway of Monte Video*, In re [1879] 11 Ch 372 was distinguished. Looking to the covenants contained in the debenture certificate, the holder of the debenture in that case to whom interest was overdue was held entitled to petition for the winding-up of the company.

20. Nearer home, in the case of *Bachharaj Factories Ltd. v. Hirjee Mills Ltd.* [1955] 25 Com Case 227, a Division Bench of this court distinguished the case of *Dunderland Iron Ore Co. Ltd.*, In re [1909] 1 Ch 446 and held that in the case before the Division Bench, there were debentures and not stock certificates. The debentures contained a personal covenant by the mills to pay to the debenture-holders. Hence the circumstances which prevailed upon the court in *Dunderland Iron Ore Co. Ltd.*, In re [1909] 1 Ch 446 were not present in the case before them and the debenture-holder was entitled to present a winding-up petition as a creditor of the company.

21. In view of the express provision now contained in section 439 of the Companies Act, 1956, there can be no doubt that a debenture-holder is a creditor of the company for the purpose of presenting a winding-up petition. In a later case of this High Court in *Sholapur Spg. and Wvg. Co. Ltd.*, In re [1965] 35 Com Case 165, a learned single judge of this court had held that a winding-up petition by a debenture-holder was maintainable in view of the direct covenant contained in the debenture certificates between the company and the debenture-holder to pay the amount to the debenture-holder, although in that case one of the relevant conditions was to the effect that the debenture was issued subject to the provisions of the trust deed whereby all remedies for the recovery of the principal money and interest secured by the debenture were vested in the trustees on behalf of the shareholders.

22. All these cases deal with the right of a debenture-holder to sue the company

or take steps against the company for recovery of his money claim under the debenture certificate. The present suit is somewhat different in character. The suit is for ensuring that the securities which are given under the debenture trust deeds and the covenants which are contained therein for the protection of debenture-holders are maintained by the company and not diluted in any manner. The debenture certificate only sets out that the debenture is issued subject to the provisions of the trust deed. There is no direct covenant between the debenture-holder and the company to the effect that the company would maintain either the fixed assets cover or profits cover as set out in the trust deeds. Therefore, strictly speaking, the ratio of the above cases does not help the plaintiff in the present case.

23. Under the terms of the deeds of trust, the covenants relating to fixed assets cover as well as profits cover are given by the company to the trustees. Under the trust deeds there are various remedies which are available to the trustees for protection and realisation of mortgage securities. Therefore, if one goes strictly by the conditions of the deeds of trust and the conditions as set out in the debenture certificates and applies the ratio of the above cases, a debenture-holder would not be entitled to enforce these covenants.

24. However, these covenants are given by the company to the trustees for the benefit of the debenture-holders. The covenant that the company would maintain certain ratio between the value of its fixed assets and the value of debentures as set out in the relevant clause and that it would maintain a certain ratio between its annual profits (to be calculated as set out in the debenture trust deeds) and the interest payable by the company, are meant to ensure that proper securities are available for realisation of dues of the debenture-holders under the debenture certificates. The debenture-holders are, therefore, beneficiaries under the trust deeds. In these circumstances, although the remedy to enforce these securities may vest in the trustees, the debenture-holders, as beneficiaries, would be entitled to enforce covenants which are for their benefit although they may not be directly parties to the covenants.

25. The right of a beneficiary under a trust to enforce contracts which are for his benefit is recognised under our law. In the case of *M.C. Chacko Vs. The State Bank of Travancore, Trivandrum*, the Supreme Court has observed as follows (at page 508) :

"... It has, however, been recognised that where a trust is created by a contract, a beneficiary may enforce the rights which the trust so created has given him. The basis of that rule is that though he is not a party to the contract, his rights are equitable and not contractual. The Judicial Committee applied that rule to an Indian case *Khwaja Muhammad Khan v. Husaini Begum* [1910] 37 IA 152; ILR [1910] All 410. ... It must, therefore, be taken as well settled that except in the case of a beneficiary under a trust created by a contract or in the case of a family arrangement, no right may be enforced by a person who is not a party to the contract."

26. The present case is covered by this exception. In Palmer's Company Precedents, Part 3, 16th edition, at page 410, remedies which are available to a debenture-holder with the aid of the court are discussed. Clause (c) refers to "Action against the company to restrain it from issuing debentures in priority to or ranking *pari passu* with the existing debentures in violation of the terms of the security". At page 416, actions to enforce secured or mortgage debenture are discussed. Under the paragraph heading "Claiming in writ where trust deed", it is set out as follows :

"Where there is a trust deed, the writ should claim a declaration as to, and the enforcement of, the charge, to have the trusts of the deed carried into execution, and the appointment of a receiver ..."

27. Form 196, at page 465, sets out the form of an action by a debenture-holder on behalf of himself and by other holders of debentures. In Butter-worth's Encyclopaedia of Forms and Precedents, 4th edition, volume 6, at page 1133, it is stated as follows : The most common mode of proceedings through the court is an action by one or more debenture-holders on behalf of all the rest

28. The present suit is filed by the plaintiff on behalf of himself and all other debenture-holders in the first and third series. The trustees are also made party-defendants to the suit along with the first defendant company. In these circumstances, in my view, the suit is maintainable. Interim relief cannot be refused on the ground of non-maintainability of the suit.

29. Has the first defendant company committed any breach of the covenants relating to fixed assets cover and profits cover while proposing the present fresh issue of debentures ? Under the debenture trust deed of the first series, the company has covenanted with the trustees to maintain a margin of 40% or such lower margin as the trustees may agree on the fixed assets and the aggregate nominal value of outstanding debentures, various other loans ranking *pari passu* and the proposed debentures. There is also provision that in case the fixed assets cover falls below its margin, the company will either provide an additional cover acceptable to the trustees or will forthwith redeem such number of debentures whose nominal values would be enough to adjust the margin. There is some dispute between the parties as to whether this margin of 40% has been subsequently reduced or not, I will come to that a little later.

30. Under the third series of debentures, the trust deed requires that the aggregate written down value of the fixed assets shall be one and a half times the value of the debentures issued and outstanding, the specified loans ranking *pari passu* and proposed debentures. Mr. Cooper, learned counsel for the plaintiff, has assumed for the purpose of the motion that the ratio between fixed assets and the aggregate value of debentures, loans and proposed debentures is as set out in the third series and not the slightly higher ratio as laid down in the first series.

31. In order to ascertain the written down value of the fixed assets of the

company and the nominal value of its outstanding debentures and other loans which rank pari passu, both the parties rely upon schedule 3 to the annual report of the first defendant company for the year 1984-85, which is annexed to the plaint. Schedule 3 sets out the various loans secured by debentures as well as other loans. The total amount of such loans taken by the first defendant company is Rs. 12,399.35 lakhs. All these loans, however, are not to be taken into account while calculating the value of outstanding loans as per the terms of the trust deeds. According to both sides, cash credit packing credit loans from banks which are of the aggregate value of Rs. 3,127.80 lakhs are not to be taken into account for calculation of the company's outstanding loans. After deduction of this figure from the total figure, the value of loans comes to Rs. 9,271.55 lakhs. It is the case of the plaintiff that these are the outstanding dues which should be covered by the fixed assets valued at one and a half times this amount. The clauses of the trust deed, however, refer only to the outstanding debentures which rank pari passu and various ICICI, foreign currency loans, outstanding amounts of GBL deferred payment guarantee, which also rank pari passu with the outstanding debentures. Hence, the various loans which are referred to in the relevant clause in the debenture trust deeds are loans which are to rank pari passu for their recovery and are secured by a first mortgage on the company's fixed assets. In my view, the first defendant company is right when it contends that only those loans which thus rank pari passu should be taken into account for calculation of the fixed assets cover. If, therefore, items Nos. 6, 18, 19, and 22 in schedule 3 to the annual report of the first defendant company for the year 1984-85 aggregating to Rs. 1,974.07 lakhs are further deducted on this basis, the outstanding secured loans which need the fixed assets cover amount to Rs. 7,296.48 lakhs. To this will have to be added the nominal value of debentures which are proposed to be issued. In other words, a further amount of Rs. 8 crores requires to be added, thus bringing the total outstanding loans to approximately Rs. 81 crores. The fixed assets cover required is, therefore, approximately Rs. 121 crores.

32. In schedule 5 to the annual report of the first defendant company for the year 1984-85, the depreciated value of fixed assets as on September 30, 1985, is shown as Rs. 11,241.89 lakhs. The auditors' report which is annexed to the annual report records that the company has maintained proper records showing full particulars including quantitative details and situation of the fixed assets, except that the item-wise depreciation written off to date has not been recorded. It seems that the company possesses old assets and there has been some difficulty in recording item-wise depreciation. The auditors have, therefore, stated that the major portion of assets has been physically verified by the management and to their knowledge there are no serious discrepancies of verification. This note of the auditors does not in any way indicate that the depreciated value which is shown in schedule 5 is in any manner inflated or is not a correct depreciated value.

33. The plaintiff had asked for inspection of the first defendant company's fixed

assets register and two ledger accounts in order to ascertain whether the depreciated value of fixed assets as shown is its correct value and whether there has been any increase in the value of fixed assets by bringing in of more machinery and so on. The company has refused to give much inspection on the ground that these are probing enquiries and a debenture-holder is not entitled to inspect these documents. Prima facie, there seems to be some substance in the contention of the first defendant company. The right of a debenture-holder of inspecting the company's records is extremely limited. u/s 209, sub-section (4), of the Companies Act, 1956, the books of account and other books referred to in that section can be inspected by the directors of the company. u/s 209A, the said books can be inspected by the Registrar of Companies or by an authorised officer of the Central Government. u/s 118 of the Companies Act, 1956, a debenture-holder has been given a right to inspect the debenture trust deed and to obtain a copy of it. u/s 163, sub-section (2) of the Companies Act, the register of members, register of indexes of debenture-holders, copies of all annual reports together with copies of certificates and documents annexed thereto can be inspected, inter alia, by a debenture-holder. In addition, under the articles of association of the first defendant company, a debenture-holder is also entitled to receive a copy of the profit and loss account and balance-sheet of the company. A debenture-holder is, therefore, not entitled to a detailed inspection of the record and registers and books of account of the company. I am not prepared to draw an adverse inference against the first defendant company for not showing to the plaintiff the fixed assets register and the two ledger accounts of which the plaintiff had asked for inspection.

34. The auditors' note also sets out that in calculating the value of the company's fixed assets, no depreciation has been provided in respect of the extra shift working of company's plant and machinery. This is contrary to the accounting practice recommended by the Institute of Chartered Accountants of India. This extra depreciation for extra shift working admittedly amounts to Rs. 6.30 lakhs. The first defendant company, however, has pointed out that it is not mandatory for the company to claim this extra shift depreciation. u/s 205 of the Companies Act, no dividend shall be declared or paid by a company for any financial year except out of the profits of the company for that year arrived at after providing for depreciation in accordance with the provisions of sub-section (2). Under sub-section (2), depreciation, inter alia, is required to be provided to the extent specified in section 350. u/s 350, the amount of depreciation is the amount calculated with reference to written down value of the assets as shown by the books of the company at the end of the financial year at the rate specified for the assets by the Indian Income Tax Act and the rules made thereunder for the time being in force as normal depreciation including therein extra and multiple shift allowances but not including various other items, with which we are not concerned. Under the relevant Income Tax Rules it is not mandatory for a company claim depreciation for extra shift working. The first defendant company has not claimed depreciation for extra shift working in its Income Tax return. The

company has, therefore, not claimed such depreciation in its balance-sheet and profit and loss account also. The contention of the plaintiff that it is mandatory for the company to claim such depreciation does not appear to be correct. It is true that the Institute of Chartered Accountants of India has recommended that such depreciation should be claimed. It has also recommended that where such depreciation has not claimed, attention should be drawn to this fact. Beyond this, there does not appear to be any mandatory provision of law under which a company is bound to claim such depreciation. For the calculation of fixed assets cover, the depreciated value of the fixed assets as shown in the company's books has to be relied upon. There is no reason to believe that the depreciated value as shown in the first defendant company's books is not correct.

35. The debentures in question are secured by a mortgage of various immovable properties of the company including its Roha Processing Plant and its Jamnagar Spinning Unit. The plaintiff has pointed out-that in fact no charge has been created on these units by the first defendant company. The first defendant company has admitted this position. It has, however, stated that a charge is in the process of being created on these fixed assets of the first defendant company. At present, the title deeds of these two properties are with the solicitors of the trustees. These have been handed over to the solicitors of the trustees in April, 1985, for the very purpose of creating a charge. The security of these two units of the first defendant company is about to be created for the benefit, inter alia, of the debenture-holders in question. There is no doubt that this security ought to have been created long back and there is a lapse on the part of the first defendant company in not creating this security earlier. But looking to the fact that the title deeds of these two plants are already with the solicitors of the trustees, it is not necessary at this stage to deduct the value of these two assets from the total value of the fixed assets available as securities to the debenture-holders in question. Thus, the value of fixed assets as shown in schedule 5 can be accepted as correct.

36. In the balance-sheet as on September 30, 1985, which is annexed to the plaint, there is an amount of Rs. 5,468.98 lakhs which is shown as unallocated expenditure. This amount is in respect of the company's DMT plant. According to the first defendant company, this expenditure will be allocated between the fixed assets and current assets of the company in the balance-sheet as on September 30, 1986, because by this time the said plant will start commercial production.

37. It is the case of the first defendant company that the DMT plant, which has been set up, has not yet started commercial production. In this connection, they rely upon "Study on expenditure during construction period", which is a booklet brought out by the Research Committee of the Institute of Chartered Accountants of India. In para 17.25, "it is recommended that the expenditure incurred on start-up and commissioning of the project, including the expenditure incurred on test runs and experimental production, may be capitalised as an indirect element of the construction cost. However, the expenditure incurred over

a prolonged guarantee period during which the plant is commercially operated cannot be capitalised and must be treated as revenue expenditure" In para 17.26, it is stated that "it is extremely important to fix a specific date representing the date when the plant has been completed, set up and is recognised as being ready for commercial production. For this purpose, the term "commercial production" refers to production in commercially feasible quantities and in a commercially practicable manner". The plaintiff has contended with some justification that at least by April, 1985, the first defendant company's DMT plant was ready for commercial production. In this connection, they rely upon the statement made by the chairman of the first defendant company on March 27, 1985, to the effect that the plant started production in December, 1984, and that the teething troubles and other problems had been overcome on the date of the statement and the plant had started its commercial functioning. The chairman also stated that the plant was expected to come into full production within the next six months. The plaintiff has also annexed orders which were placed by third parties for the supply of DMT manufactured at the said plant. The plaintiff also relies on the monthly production return for the month of September, 1985, filed by the company before the Director-General of Technical Development, In this return, the company has stated that the factory was not working at full capacity because of paucity of orders. It stated, inter alia, that the production was planned to meet the orders received. Low production was, therefore, not on account of the plant not being ready for commercial production, but on account of market conditions. There is, therefore, a factual basis for the plaintiff's contention that the plant had started commercial production by April, 1985, and hence the unallocated expenditure should have been allocated in the balance-sheet as on September 30, 1985. The first defendant company, however, contends that the said plant was not functioning in a commercially practical manner by April, 1985, since the quantity of production was small. In my view, the small quantity of production by itself is not enough for establishing that the plant was not ready for commercial production. The company ought to have allocated the expenditure on the plant by September, 1986. Anyway, for the purpose of valuation of fixed assets of the first defendant company, it is only necessary to note that a substantial amount is shown in the balance-sheet as on September 30, 1985, as unallocated expenditure and some part of this amount will go to increase the value of fixed assets of the company. In the balance-sheet as on September 30, 1985, a sum of Rs. 7,232,51 lakhs shown as value of capital work in progress and advances for capital expenditure in connection with the DMT plant, has been taken into account while calculating the value of the fixed assets of the first defendant company. There is, however, a sum of Rs. 5,468.98 lakhs which is shown in the balance-sheet as expenditure pending allocation in connection with the DMT plant of the first defendant company. According to the first defendant company, on allocation of this amount, an amount approximating Rs. 34 cores will go towards the value of fixed assets of the first defendant company while the balance amount will be shown as current

assets.

38. I need not examine the reasons for not allocating this expenditure as on September 30, 1985. It is possible, as contended by the plaintiff, that if the expenditure had been allocated in the balance-sheet as on September 30, 1985, although the value of the fixed assets of the company would have substantially increased, it is also likely that its profits would have been substantially reduced on account of a large amount being allocated for revenue expenditure. But, for the purpose of calculating the value of fixed assets cover of the first defendant company, one cannot ignore the fact that the fixed assets of around Rs. 34 crores in addition to 112 crores of rupees are available to the first defendant company. If this amount is taken into account, there is adequate cover of fixed assets amounting to Rs. 146 crores (approx). for the debentures outstanding, the specified loans and the proposed debentures amounting in all to Rs. 81 crores.

39. Under the relevant trust deeds relating to the first series of debentures, the company was required to have fixed assets of the value of 166% of the value of the aggregate outstanding debentures, the proposed debentures and other loans which all rank pari passu. But the debenture-holders of the first series by a special resolution passed at a general meeting of debenture holders held on January 24, 1986, have, inter alia, agreed that the security cover of one and a half times the value of the said borrowing will suffice. The third series of debentures also require the same cover. Thus, the first defendant company does seem to have complied with the covenants relating to fixed assets cover to be provided in respect of the said proposed debentures.

40. The second covenant under the debenture trust deeds in the first series requires the company to maintain a ratio of 2 : 1 between the average profits of the company for the previous three years to be calculated in the manner set out in the said covenant and the amount required to be paid as an aggregate of one year's interest on the said debentures and loans specified therein including interest on the additional debentures proposed to be issued. The existing burden of interest as shown in the annual report for the year 1984-85 in schedule 15 is Rs. 570.39 lakhs. This amount is divided into two parts - Rs. 279.06 lakhs is interest on fixed loans and Rs. 291.33 lakhs is interest on others. To this has to be added a sum of Rs. 120 lakhs being interest on the proposed debentures. The total quantity of interest payable would thus come to Rs. 690.39 lakhs. According to the first defendant company out of a total of Rs. 570.39 lakhs shown in schedule 15, only a sum of Rs. 270.06 lakhs should be taken into account for calculation of interest under the relevant covenant relating to profits cover. Under the covenant, interest to be taken into account is interest on the amount of outstanding existing debentures, the amount of outstanding debentures of Rs. 2.50 lakhs and ICICI foreign currency loan, GBL deferred payment and interest on the amount of additional debentures proposed to be issued. It is not clear whether interest on any of these loans forms a part of Rs. 291.33 lakhs shown as

interest "on others" or not. In these circumstances, if we take into account the total interest payable as Rs. 690.39 lakhs, it is necessary that the first defendant company should have twice this amount as its average yearly profits to be calculated as set out in the covenant. As per exhibit I to the plaint where net average profit of the first defendant company has been calculated, the average profit for the last three years comes to Rs. 1,074.64 lakhs per year. This amount includes profit derived from the sale of capital assets of the company also. According to the plaintiff, such profit should be excluded from calculation though I do not see any reason for excluding such profit. But one has also to take into account the fact that this average profit may be reduced after the allocation of unallocated expenditure, although this is denied by the first defendant company. Prima facie, there does not seem to be an adequate profits cover. In fact, Mr. Jethmalani, learned counsel for the first defendant company, did not even urge seriously that the company had the requisite profit cover.

41. In this connection, it was argued by Mr. Jethmalani, learned counsel for the company, that in the third series of debentures, the covenant in question only requires the company to ensure that the average of profits are sufficient as far as possible to cover at least twice the amount required to be paid as an aggregate of one year's interest on the prescribed loans and including the proposed debentures. The relevant covenant in the third series of debentures is as follows :

"..... The average of profits of the company after charging interest on loans for working capital and expenses of working and management including maintenance and repairs but before charging the interest on term loans/deferred payment facilities/guarantee facilities, depreciation, development rebate, investment allowance reserves and taxes for the three accounting years from which accounts have been audited last preceding the date of any such further issue or raising of term loans or availing of deferred payment guarantee facilities are sufficient as far as possible to cover at least twice the amount required to pay the aggregate of one year's interest on the amount of the debentures issued and outstanding and the outstanding term, loans, deferred payment or guarantee facilities and on the amount of further debentures, term loans, deferred payment/guarantee facilities."

42. He construed this clause as more in the nature of an exhortation than a legal requirement. I am afraid. I cannot accept this interpretation of the clause. The clear intention of the parties in making that covenant was to stipulate that the average profits would be twice the amount of interest. This was a requirement which was to be complied with as far as possible, meaning thereby that a small deviation would be permissible and an exact mathematical equation may not be mandatory. Nevertheless, an approximation to this norm was certainly covenanted for. If there is any wide deviation from this norm, then the covenant must be interpreted as having been breached.

43. In Anson's Law of Contract, 26th edition, page 136, it is stated as follows :

"An agreement ought to receive that construction which its language will admit which will best effectuate the intention of the parties to be collected from the whole of the agreement and greater regard is to be had to the clear intent of the parties than to any particular words which they may have used in the expression of their intent. The proper mode of construction is to take the instrument as a whole, to collect the meaning of words and phrases from their general context, and to try and give effect to every part of it."

44. In the case of *Glynn v. Margatson and Co.* [1993] AC 351, the House of Lords was required to consider a bill of lading which contained a clause that the ship was bound for Liverpool, with liberty to proceed to and stay at any port or ports in any station in the Mediterranean, Levant, Black Sea or Adriatic or on the coasts of Africa, Spain, Portugal, France, Great Britain and Ireland, for the purpose of delivering coals, cargo, or passengers or for any other purpose whatsoever. The ship left Malaga for a port on the east coast of Spain and out of her course for Liverpool. The appellants had shipped cargo of oranges for Liverpool which was damaged as a result of delay. In construing this clause, the House of Lords held that in construing a document one must in the first instance look at the whole instrument and not one part of the agreement. Looking at the whole of the instrument and seeing what one must regard, as its main purpose, one must reject words, indeed the whole provision, if they are inconsistent with what one assumes to be the main purpose of the contract; and the House of Lords held that the appellant was entitled to damages.

45. The covenant in question in the third series of debentures is also meant for the protection of debenture-holders and it cannot be construed as merely an exhortation. It does appear that the company has not complied with that covenant either in the first or in the third series.

46. In the debenture trust deeds of the first series, however, clause 55 of the original debenture trust deed of June 2, 1965, provides that the debenture-holders shall in general meeting have the power by special resolution to sanction any modification of the rights of the debenture-holders against the company or against its property. A special resolution passed at a general meeting of the debenture-holders duly convened is made binding upon all the debenture-holders whether present or not. The expression "special resolution" is defined as a resolution passed at a meeting of debenture-holders duly convened and passed by a majority consisting of not less than three-fourths of the debenture-holders voting thereat either upon a show of hands or if a poll is duly demanded then by a majority consisting of not less than three-fourths of the votes given on such poll. These provisions are incorporated in all the subsequent trust deeds of the first series. Before the issue of the present impugned series of debentures, a general meeting of the debenture-holders of the first series was held on January 24, 1986. At this meeting, two resolutions were passed. The first resolution is to the following effect :

"RESOLVED that pursuant to the provisions of the debenture trust deed dated

June 2, 1965, as modified by the supplemental trust deed dated August 28, 1980, made between the company and the Investment Corporation of India Ltd. for securing the 3,50,000, 11% (now increased to 12%) secured redeemable debentures of Rs. 100 each and subject to such other consents or approvals as may be necessary and subject also to such terms, conditions, alterations or modifications as may be specified while granting such consents or approvals with the board of directors of the company be and is hereby authorised to accept, the consent of the aforesaid debenture-holders be and is hereby granted to the board of directors of the company mortgaging and/or charging all or any of the present and future movable and immovable properties of the company wheresoever situate and the whole or any part of the undertaking of the company (such security to rank *pari passu* with or subject to the charges already created or to be created in favour of the company's bankers and/or the financial institutions and/or trustees of the existing debenture-holders from time to time as the case may be) together with the power to take over the management of the business and concern of the company in certain events, to or in favour of the agents and trustees for the holders of 800,000 (eight lakhs), 15% secured redeemable non-convertible debentures of the face value of Rs. 100 each to be issued by the company in order to secure their redemption together with interest, compound interest, costs, charges, commitment charges, wherever applicable, premium on prepayment or on redemption, if applicable, and all other monies due or payable by the company in respect thereof or any part thereof." (underlining (Here printed in italics.) mine).

The second resolution is to the following effect :

"RESOLVED FURTHER that consent be and is hereby accorded to the board of directors mortgaging and/or charging all or any part of the immovable properties of the company wheresoever situate, present and future of every nature and kind whatsoever and/or creating a floating charge on all or any of the movable properties of the company wheresoever situate, to or in favour of any financial institutions and/or banks to secure the repayment of the monies hereafter borrowed by the company or other guarantee facilities obtained by the company or the redemption of any debentures (convertible or non-convertible) hereafter issued by the company either to the existing debenture-holders or to the public or on private placement basis for or in connection with the company's textile division at Bombay, Roha, Jamnagar or DMT division or such other projects as the board may from time to time approve provided that the total borrowings of the company whether by way of loans and/or issue of debentures and/or guarantee facilities obtained by the company as aforesaid shall not in any event exceed the limit of Rs. 100 crores as sanctioned by the shareholders u/s 293(1)(d) of the Companies Act, 1956, at the 101st annual general meeting held on August 29, 1980, and provided that the company maintains at all times a security cover of at least 1.5 times of net fixed assets over all long-term borrowings which may have a first charge over the fixed assets." (underlining (Here printed in italics.) mine).

47. A third resolution was also passed authorising the Board to do all consequential acts. Under the covenants contained in the debenture trust deed, debenture-holders are required to pass a special resolution whenever a new series of debentures is being issued to rank *pari passu* with the debentures covered by this trust deed. The first resolution presumably is such a resolution. The second resolution, however, varies some of the covenants given under the said debenture trust deeds. Under the second resolution, the board of directors of the first defendant company becomes entitled to mortgage and/or charge the company's various properties - movable and immovable - in favour of any financial institutions or banks, etc., so long as the total borrowings of the company whether by way of loans and/or issue of debentures and/or guarantee facilities obtained by the company do not in any event exceed the limit of Rs. 100 crores. Secondly, the company is required to maintain at all times a security cover of at least 1.5 times the net fixed assets over all long-term borrowings which may have a first charge over the fixed assets. Thus, by virtue of these two resolutions, the company has become entitled to borrow further amounts so long as it complies with these two conditions and nothing more. By virtue of this resolution, therefore, the debenture-holders of the first series of debentures have given up the covenant requiring the company to provide a profit cover. Since it was a covenant for the benefit of the debenture-holders, the debenture-holders could waive that benefit. The debenture trust deed also gave an express power to the debenture-holders to modify this covenant. Therefore, by virtue of this special resolution which is passed in accordance with the provisions of the sixth schedule to the original trust deed, the debenture-holders of the first series cannot now insist on a profit cover. This resolution was passed unanimously at the meeting of the first series of debenture-holders. 70% of the total debenture-holders by value were present at the said meeting and they all agreed to the said two resolutions. The resolution is, therefore, binding on all the debenture-holders of the first series including the plaintiff.

48. In respect of the third series of debentures, however, there is no provision under the debenture trust deed for any modification of covenants by debenture-holders passing such a resolution. Nevertheless, since the covenant is for the benefit of debenture-holders, debenture-holders can, under general law, waive such a benefit. In the present case, on January 24, 1986, a meeting of debenture-holders of the third series was also held where the same two resolutions which were passed by the first series of debenture-holders were also passed by the debenture-holders of the third series. At this meeting 96% in value of the debenture-holders in the third series were present. They unanimously voted for these two resolutions. Incidentally, 96% in value of debentures in the third series are held by financial institutions. Only 4% are subscribed to by members of the public. All these financial institutions have also given separately their consent to the present new issue of debentures. The trustees under the first and the third series of debentures have also given their consent to the new issue of debentures. The only point that requires

consideration is whether this resolution would be binding on the balance 4% of debenture-holders in the third series. The first defendant company, however, has made an offer that if any debenture-holder in the third series is not satisfied with the profit cover available for payment of interest to him, the company is willing to return the amount payable to him under the debenture certificates held by such a debenture-holder immediately on being called upon by the debenture-holder to do so. In view of this offer, the remaining 4% of debenture-holders, if they so desire, will be entitled to a return of all the monies under their debenture certificates from the first defendant company.

49. The plaintiff has raised some other objections to the new issue, e.g., he contends that the company has not complied with the conditions laid down by the Controller of Capital Issues while granting his consent to the new issue because the company has not submitted periodic reports as required by the terms of the consent. If this is so, it is a matter which the company will have to rectify. Essentially, it is a matter between the Controller and the company.

50. Looking to all the circumstances, the balance of convenience is also overwhelmingly in favour of the first defendant company being allowed to issue the proposed debentures. The company has already received money from the public for the proposed debentures. Not being allowed to issue the debentures would cause serious prejudice both to the company and to the persons who have subscribed to the new series. the risk of any damage to the plaintiff is minimal. But the present notice of motion substantially affects the outcome of the suit. Hence, I do not propose to decide the motion on the basis of balance of convenience.

51. The first defendant company has also submitted that the present application is a mala fide application made on behalf of its trade rivals in order to bring the working of the first defendant company into difficulty. It has urged this ground also to resist the application of the plaintiff for a detailed inspection of the company's records. The company has considered this attempt at inspection an attempt by its trade rivals to obtain information regarding the company's plant and machinery. In support, the first defendant company has relied upon a spate of articles and newspaper reports recently appearing where allegations have been made against the first defendant company and its chairman. There does appear to be some basis for this apprehension. It is somewhat unusual for a debenture-holder who holds debentures of the total value of Rs. 2,00 to engage in such heavy battle against the company although the first defendant company at the outset had offered to return the entire amount payable under the debenture certificates to the plaintiff. But the plaintiff did not take up the offer. The plaintiff has obtained leave under Order 1, 8 of the CPC and he claims to have filed the suit in a representative capacity. But looking to the unanimous resolutions passed by the debenture-holders and looking to the fact that the financial institutions who had 96% of debentures in the third series and 58% of debentures in the first series have consented to the new issue, the

representative character of the plaintiff does appear to be a little doubtful. The allegation of mala fides cannot, therefore, be lightly brushed aside. I prefer, however, to dispose of the motion on the basis of disclosed material and on merits, irrespective of the alleged motives of the plaintiff.

52. In the circumstances, there will be no order on the notice of motion, save and except that such of the debenture-holders of the third series (other than financial and public institutions) who want to recover the amounts payable under their debenture certificates will be entitled to recover the same if they apply to the first defendant company for such payment within 12 weeks from today. For this purpose, the company will issue a circular letter to the balance 4% of debenture-holders in the third series informing them of their right to receive immediately the amount under their debenture certificates.

53. The proposed allocation of debentures will, however, be subject to the outcome of the suit.

54. In the circumstances of the case, there will be no order as to costs.

55. Mr. Kotval, learned counsel for the plaintiff, applies for continuance of the interim order for a period of one week from today.

56. Originally pending the disposal of the motion, the first defendant company had by consent between the parties made a statement that they would not issue debentures till July 2, 1986, although the entire series had been subscribed to. For various reasons which need not be examined, as the motion was not likely to be disposed of by that date, on July 1, 1986, the statement was extended for the entire period during the pendency of the motion. I do not see any reason why any stay should be granted now preventing the first defendant company from issuing new debentures. The company has received monies as far as back as May, 1986, and it has not issued debentures so far entirely because of the statement made during the pendency of motion. In my view, it would not be in the interest of the proposed debenture-holders to hold up the issue of proposed debentures. The application for stay is rejected.