

(2014) 10 KAR CK 0248
In the Karnataka High Court
Case No : Companies Appeal No. 3 of 2014

NSR Gastronomy (Mauritius) LLC

APPELLANT

Vs

K.N. Vasudeva Adiga and Others

RESPONDENT

Date of Decision : 15-10-2014

Acts Referred:

Arbitration and Conciliation Act, 1996 — Section 8
Companies Act, 1956 — Section 397, 398, 402

Citation : (2015) 126 CLA 287 : (2015) 189 CompCas 476 : (2015) 3 CoMPLJ 185 : (2015) 2 KarLJ 261

Hon'ble Judges : N. Kumar, J;B. Manohar, J

Bench : Division Bench

Advocate : K.G. Raghavan, Senior Counsel and Namrata Kolar, Advocates for the Appellant; Sriyuths Udaya Holla, Senior Counsel for Holla and Holla and N.K. Dilip, Advocates for the Respondent

Judgement

N. Kumar, J.—The second respondent in the petition before the Company Law Board has preferred this appeal against the impugned order dated 22-5-2014, appointing Administrator and Committee of Management replacing the Board of Directors and issuing further directions for running of the company. For the purpose of convenience, the parties are referred to as they are referred to before the Company Law Board.

2. M/s. Vasudeva Adigas Fast Food Private Limited is a private company involving in the food and beverages business and has its registered office at No. 36, 12th Main, 27th Cross, IV Block, Jayanagar, Bangalore. It is the first respondent before the Company Law Board.

3. The second respondent-NSR Gastronomy (Mauritius), LLC became a significant shareholder of the first respondent-Company by purchasing about 18,017 ordinary equity shares from the petitioners before the Company Law Board. The petitioners and Smt. Vinoda Adiga, wife of the first petitioner subscribed to 51 Class A Series equity shares representing 51% of the Class A Series equity

shares of the company, 1,50,000 Series A compulsory Convertible Preference Shares (CCPS) representing 100% of the Series A CCPS and 39,619 Series B CCPS representing 100% of the Series B CCPS by and under the shares subscription-cum-share purchase agreement dated 24-3-2012. The second respondent holds majority i.e., 51% of the voting rights in the first respondent-company. The shareholding agreement provided for composition of the Board. The Board shall consist of upto 12 Directors. On second closing, the Board shall comprise of 5 Directors which shall consist of 2 Directors nominated by the Promoters in accordance with Clause 5.2(a) and 3 Directors nominated by the Investors under Clause 5.2(b). Notwithstanding the appointment of the independent Directors as per Clause 5.3, as long as the Investor share holding percentage is at least 51% or is holding 51 Class A equity shares, the investor Directors shall constitute majority of the Directors. The persons nominated, as per the terms contained in Clause 5.1 shall be appointed as Director/s of the Board. However, if the shareholding percentage of the promoters in the company falls below 20%, then the promoters shall be entitled to nominate only one person to the Board and appoint one non-voting observer. The Promoters shall not be entitled to any representation of the Board either as nominee Director or as observer, if the shareholding percentage of the promoters in the company falls below 10%.

4. Clause 5.4 provides the promoter-Mr. K.N. Vasudeva Adiga shall be involved in the management of the company as the Chairman of the Company and shall continue as such till the shareholding percentage of the promoters in the company falls below 10% or till the promoters commit a material breach of the Subscription Agreement or the Shareholders Agreement which is not cured within 30 days from the date of notice issued by the Investor. The Chairman shall not have a second or casting vote in the event of an equity of votes at Board meetings or general meetings of the company. The promoter-Mr. K.N. Vasudeva Adiga is a whole time Director in the company earning a salary as per the terms to be agreed by and between the promoters and the investors.

5. Clause 2 of the agreement deals with investment. Clause 2.1 of the agreement reads as under:

"2.1 Subject to the terms and conditions of this agreement and relying on the representation and warranties made by the promoters to the company and the Investor, the Investor hereby agree to invest upto Rs. 165,00,00,000/- (One Hundred and Sixty-five Crores) in the company ("Total Investment Amount") in the following manner:

2.1.1 Tranche A Investment: Invest an amount of Rs. 4,50,00,000/- (Rupees Four Crores and Fifty Lakhs) towards subscription of 1,50,000 Series A CCPS ("Series" A CCPS Subscription Amount) in accordance with Clause 4.

2.1.2 Tranche B. Investment: Invest an amount of Rs. 83,75,00,000/- (Rupees Eighty-three Crores and Seventy-five lakhs) in accordance with Clause 5 towards.

2.1.2.1 Subscription of 51 Class A Equity Shares with a par value of Rs. 10/- for an amount of Rs. 15,55,000/- ("Class A Equity Subscription Amount").

2.1.2.2 Subscription of 39,619 Series B CCPS for an amount of Rs. 39,61,91,000/- ("Trance B Series B CCPS Subscription Amount") and

2.1.2.3 Purchase of 14,427 ordinary equity shares for an aggregate amount of Rs. 43,97,54,000/- from the promoters ("Trance B Share Purchase Amount").

2.1.3 Trance C Investment: The investor will invest the third Trance investment of Rs. 13,25,00,000/- (Rupees Thirteen Crores and Twenty-five Lakhs only) ("Trance C Share Purchase Amount") towards purchase of 3590 Ordinary Equity Shares from the promoters in accordance with Clause 6.

2.1.4 The investor can invest the balance of the total investment amount of Rs. 63,50,00,000/- (Rupees Sixty-three Crores and Fifty Lakhs only) ("Additional Series B CCPS Subscription Amount") in the company towards subscription of 63,500 Series B CCPS in various trenches as detailed in Clauses 7.1 and 7.2 during the investment period at the same price at which Series B CCPS are subscribed by Trance B Series B CCPS Subscription Amount.

2.1.5 The aggregate of the Additional Series B CCPS Subscription Amounts shall be referred to as the Aggregate Additional Series B CCPS Subscription Amount".

6. Schedule 11, Part A deals with determination of post money equity value of company. Clauses 1 and 2 reads as under:

"1. Determination of post money equity value of company.--The post money equity value of the company shall be determined after EBITDA from existing business and EBITDA from proposed business is available and determined in the following manner:

1. Post money equity value means the aggregate of the final pre-money equity value and the total subscription amount;

2. Present pre-money equity value is Rs. 184,54,42,106/- (Rupees One Hundred and Eighty-four Crores Fifty-four Lakhs Forty-two Thousand One Hundred and Six only). Present pre-money equity value is sum of:

a. Existing business present pre-money equity value of Rs. 155,99,35,087/- (Rupees One Hundred and Fifty-five Crores Ninety-nine Lakhs Thirty-five Thousand Eighty-seven only); and

b. Proposed business present pre-money equity value of Rs. 28,55,07,019/- (Rupees Twenty-eight Crores Fifty-five Lakhs Seven Thousand and Nineteen only)".

7. From the aforesaid clauses, it is clear that the investors agreed to invest upto Rs. 165 Crores in the manner set out above. It is not in dispute between the parties so far as a sum of Rs. 101 Crores is invested. In terms of the agreement, Rs. 64 Crores are yet to be invested. In the meanwhile, in working of this

agreement, disputes arose between the parties. Therefore, the promoters-Directors approached the Company Law Board with a petition under Sections 397 and 398 read with Section 402 of the Companies Act, 1956 complaining of oppression and mismanagement by respondents 2 to 5 seeking a declaration that the resultant shareholding percentage of second respondent be computed on the basis of forecasted EBITDA itself as originally agreed instead of the Actual EBITDA for the year ended 31st March, 2013 as mentioned in the definitive agreements in view of the fact that the 1st petitioner was prevented from managing the affairs of the company during this period; to declare that the removal of the petitioner 1 from the office of the Managing Director vide circular resolution dated 12-8-2013 as null and void and non est. in law; and to declare that the appointment of respondent 3 as the Managing Director of the Company vide circular/resolution dated 12-8-2013 as null and void and non est. in law; to declare that the resolution passed at the extraordinary general meeting of the company dated 24-1-2013 appointing BSR and Associates as the statutory auditor as ultra virus the articles of Association of the Company and to appoint another Statutory Auditor in their place and for other consequential relief"s. Interim order was also sought for. One such interim order was to appoint an Administrator to manage the affairs of the company on terms as may be deemed necessary by the Company Law Board.

8. This petition was filed on 13-1-2014. After service of notice on the respondents, on 23-1-2014 the interim order came to be passed restraining the respondents 2 to 5 from utilizing the funds of the company for the purpose of litigation between the parties in a manner whatsoever, restraining the respondents 3 and 5 from passing any resolution of the Board without the permission of the company and respondent 2 was directed to provide the documents sought for in the petition. The said interim order was to be in force till 5-3-2014. A direction was also issued restraining the respondents 2 to 5 from utilizing the funds of the company for carrying on any other business even for the business in "Food and Beverages" and injunction was also granted restraining respondents 1 to 5 from any manner alienating, encumbering or otherwise disposing of the property rights including the trademarks such as "Adigas" and "Vasudeva Adigas" until further orders. Respondents were directed to file counter to the petition within four weeks and matter was posted to 4th March, 2014. Before the aforesaid hearing date on 13-2-2014 Company Application No. 1 of 2014 is filed for appointment of an Administrator to over see the affairs of the company and for an injunction restraining the respondents 2 to 5 from convening and conducting the Board meeting on 18-2-2014 or any other date till the disposal of the company petition and for an injunction restraining the respondents not to interfere with the convening of the meeting by the 1st petitioner as the Chairman of the company and also an order restraining the respondents 2 to 5 from convening any extraordinary general meeting without the leave of the Company Law Board. On 25-2-2014 counter was filed. Petitioners filed their rejoinder on 18-3-2014, written statement was also filed on

21-5-2014 and impugned order came to be passed on 22-5-2014. The impugned order was passed appointing Justice K.N. Keshavanarayana, retired Judge of the Karnataka High Court as Administrator of the 1st respondent-company. Further, it was ordered as the learned Administrator will Head the Committee of Management replacing the Directors as on date and the Committee of Management will have four members. Two to be nominated by the applicants and two by the company. Thereafter the learned Administrator shall convene the first meeting by giving 7 days notice in advance to Committee Members and shall consider all pending issues concerning the affairs of the company and take decision in accordance with law. Further a direction was issued to the Company Secretary. Aggrieved by the said order the present appeal is filed.

9. On 10-6-2014 an interim order was passed by this Court restraining the persons in management from taking any major decisions and at the same time, the impugned order shall not be given effect to until further orders. Interim order was continued from time to time. On 7-10-2014 by consent of parties M/s. Maniam Suresh, Sundar, Vittal and Company, were appointed as Auditors to audit the accounts of the company for the period 2012-2013 and 2013-2014 keeping open all contentions of both the parties. Today the matter is taken up for final hearing.

10. From the facts set out above it is clear that during the transition disputes have arisen between the parties. The grievance made out in the company petition is the action of the respondents 3 to 5 were not in terms of the letter and spirit of the agreement, but also were detrimental to the petitioners and other shareholders of the company. Respondents 3 to 5 have failed to convene the Board Meeting at regular intervals. The respondents have failed in appointing statutory Auditor of the company in terms of the definitive agreement. The annual general body meeting was not convened. By such conduct of business, operational losses in the business has occurred. The Directors representing the promoters were totally side lined. They are not provided with information relating to the affairs of the company. The companies profitability also declined leading to erosion of valuation affecting the name fame, goodwill and reputation built by the petitioners in running the restaurant in and around Bangalore. Respondent 3 in his capacity as Director is not conducting the affairs of the company in a proper manner. The Company Law Board prima facie felt all these allegations has been established and therefore, had proceeded to pass the impugned order.

11. Assailing the impugned order the learned Senior Counsel appearing for the company contended that when the prayer in the application is for appointment of an Administrator to over see the affairs of the company before the Committee, a serious error has occurred in appointing the Administrator to run the affairs of the company. Similar prayer had been made in the original petition itself, though the Board granted interim orders the said interim order was not granted, when it was granting the impugned order on 22-5-2014, there was no change of circumstances justifying such an order. The rights of the parties are clearly set

out in the agreement. The company has paid nearly Rs. 65 Crores i.e., the amount payable to the petitioners. They have also invested another Rs. 35 Crores. They are ready and willing to pay the remaining Rs. 65 Crores for which consent of the petitioners was necessary, which was not granted. When the company did not commit any breach of the terms of the contract, the Company Law Board without properly looking into the terms of the agreement and the rights of the company, ignoring the same has passed the impugned order which is patently illegal. In terms of the agreement, the 1st petitioner was removed from the Office of the managing Director on 7-8-2013 which was not questioned by the 1st petitioner then. It is only in these proceedings the same is questioned. In terms of the agreement of the investors i.e., the company is entitled to appoint three Directors, two Directors are already appointed. The third Director is also functioning as an Additional Director. It is only when the meeting was called for appointment of third Director, the petitioners have rushed to the Court obtained the interim order and prevented the company from convening the Board Meeting to consider the appointment of the third Director in terms of the agreement. The grievance of the petitioners is that the respondents are not conducting the business in a profitable manner. Business has suffered loss and therefore, while ascertaining the value of the share of the petitioners as there is reduction in EBITDA the petitioners would suffer losses. He submits that the said apprehension has no basis. The prayer in the petition is that there is decline in the shareholding percentage on the basis of the forecasted EBITDA. If the petitioners ultimately succeeds in the petition, the losses sustained by them could not be made up. The Company Law Board committed a serious error in passing the order appointing the Committee displacing the existing Directors. Elaborating his contention he submitted that the material on record discloses that during the period from 9-4-2012 to 16-1-2013 the respondents have convened 7 board meetings. Petitioner 1-as Chairman participated in the meetings and has signed the resolutions. In addition to the Board meetings, 14 review meetings were convened the particulars of the board meetings are found in paragraphs 20 and 21 of the appeal memo. Subsequently meeting was convened on 27-6-2013 and notice of the meeting was served on 14-6-2013, the 1st respondent sent a reply stating the said date is not convenient. Again one more meeting was convened on 13-8-2013. In the said meeting they included the agenda which the petitioners wanted in the meetings convened. Petitioners are party to the same. In terms of the agreement Auditor should have been appointed. In fact one M.V. Manjunath was the auditor in the Annual General Meeting. However, he resigned on 4-10-2012 and statutory Auditor could not be appointed because of non-co-operation on the part of the petitioners. When the respondents have paid Rs. 65 Crores, which is the amount which is legally due to the petitioners and Rs. 35 crores is paid towards improvement of the business for expansion, the Company Law Board committed serious error in ignoring this factual aspect, while passing the impugned order.

12. Per contra, the learned Senior Counsel appearing for the petitioners

contended that after due diligence the total value of the assets of the company was determined at Rs. 184.54 Crores. In terms of the agreement 51% shareholding was given to the respondents and a sum of Rs. 57.2 Crores was received. Under the agreement Rs. 165 Crores is the amount to be invested, whereas Rs. 101 Crores is invested. Without consulting the 1st petitioner he was removed from the post of the Managing Director and in his place respondent 3 is appointed. Respondent 3 is running the affairs of the company without reference to the Board and the Directors. The learned audit report on which they rely on shows the loss the company has sustained over the years. There is sudden decline in the profits earned by the company. If that trend continues the petitioners shareholding would come down to 10% and that would result in their to losing complete control over the company. That precisely appears to be the object behind the entire exercise. Therefore, he submits exercising power under Section 402 of the Companies Act, the Company Law Board has passed an equitable order protecting the interests of both the factions. It is in accordance with law and no case for interference is made out.

13. In the light of the aforesaid facts and the relevant materials on record, the point that arise for our consideration is:

Whether a case for interference with an equitable order passed by the Company Law Board is made out?

14. It is not in dispute that the petitioners have entered into an agreement with the respondents on 24-3-2012 which is styled as share subscription-cum-share purchase agreement, Part A of Schedule 11 discloses that the post money equity-- value of the company shall be determined after EBITDA from existing business and EBITDA from the proposed business is available and determined. The present pre-money equity value is determined at Rs. 184,54,42,106 Crores. Clause 2 which deals with the investment profits subject to the terms and conditions of the agreement and relying on the representation and warranties made by the promoters to the company the investors agreed to invest upto Rs. 165 Crores. The manner of investment is clearly set out.

15. Accordingly for purchasing 14,427 ordinary equity shares from the promoters an amount of Rs. 43,97,54,000/- is paid to the petitioners. They have also paid a sum of Rs. 13,25,00,000/- towards purchase of 3,590 ordinary equity shares from the promoters. In all Rs. 57,22,54,000/- Crores has been paid to the petitioners. The remaining amount has to be invested in the manner set out in the agreement. As against Rs. 165 Crores a sum of Rs. 101 Crores is already invested. In terms of the agreement the promoters are entitled to appoint two Directors whereas the investors would appoint three Directors. Investors have already appointed two Directors and the third Director is already working as an Additional Director since earlier. It is only when for his appointment as a Director, meeting was convened and trouble started between the parties. Before this Court six volumes of documents are produced. It is submitted the said documents are also produced before the Company Law Board. But we do not find any reference.

Four volumes were produced before the Company Law Board and in addition before this Court two additional volumes are produced. However, in the impugned order we do not find any details in this regard.

16. But what appears from the material on record is that it is clear the promoters were running this business in a profitable manner. Now the respondents have invested upto 51% in the shareholding. Under the said agreement substantial portion of the amount is already paid and invested. A letter extracted in the impugned order shows the relationship between the CEO-the 3rd respondent-Managing Director and the Chairman of the Company is strained. The Chairman is from the group of promoters. Managing Director is from the group of investors.

17. The grievance of the petitioners is that the Managing Director is not consulting or taking the Chairman into confidence. The grievance of the CEO is that the Chairman is coming in the way of managing and therefore, it is not possible to run the business in a peaceful manner. Though on the day of agreement was entered into there were 12 outlets. Subsequently another 12 outlet were added. Though there is no audit report by a statutory Auditor as he could not be appointed because of difference of opinion between the petitioners and the respondents relating to audit report, yet according to him shows some of the outlets have been closed. Majority of the outlets are running under loss, thereby 49% of the shareholding is in serious jeopardy. He is attributing all this to the way the business is run by the CEO Managing Director. When an attempt was made to appoint the third Director, he has rushed to the Court against the two Directors. The voice of the promoters would not be heard in the company. Though the allegations of non-convening the meetings are made, the material on record shows meetings were convened. It is only later when meetings were convened as there was no co-operation in carrying on the business, at the same time when the respondents undertook to invest nearly Rs. 165 Crores and they have already invested Rs. 101 Crores probably to take complete control even before the investment of Rs. 165 Crores, an attempt was made to appoint their Director. Now that is resisted. The business that is being carried on is the Hotel business. Petitioners' good will, trade name is the basis on which the business could be carried on. Now an attempt is made to exclude them though they have 49% shareholding. Still the entire amount agreed is not yet invested. In fact this Court has appointed a statutory Auditor to look into the accounts. In fact a letter of the CEO which is extracted in the impugned order clearly demonstrates that the existing units are declining despite the price increase and therefore, the contention of the petitioners that the business is being run under loss and if the trend continues their shareholding will come down below 10% in which event they will lose complete control over the company, cannot be dismissed as without any basis. It is in this context the Company Law Board though not has carefully looked into the other documents produced, but taking into consideration the totality of circumstances has passed the impugned order to protect the interest of both the parties. However, in order to achieve the said object the order replacing the Board of Directors, is too harsh. After passing the said order

liberty is given to the factions to appoint two members/groups in the Committee of management. As a consequent equal opportunity is given to both the factions in the existing Board of Directors. We do not see any justification to appoint persons other than the persons who are already Directors in the interest of the two factions. In fact the Chairman belongs to one faction, the Managing Director belongs to another faction. In the circumstances, the proper course would be to allow the Board to convene a meeting under the supervision of the Administrator, whom the Board has appointed. He would act as a bridge between the two factions and he could advised them to take a decision in the best interest of running of the business and would assist them in running the business in a professional manner. Now that this Court has already appointed a statutory Auditor to audit the accounts for two years and interim orders are passed to protect the interest of both the persons, we are of the view, the order passed by the Board could be modified appointing the learned Judge as Administrator permitting him to participate in the Board meetings where both the sides are represented equally and to ensure that the affairs of the company are conducted in accordance with law and to assist them in case of any divergence of opinion. That would meet the ends of justice.

18. Sri K.G. Raghavan, learned Senior Counsel submitted that in terms of the agreement the investors have a right to appoint a third Director. There cannot be any dispute as far as the Chairman and the Director are concerned. In the contract the investors have agreed to pay Rs. 165 Crores. As on today they have not invested the complete amount. 51% belongs to investors and 49% belongs to the promoters as stated earlier. During transition period itself dispute has arisen. In fact interim order is passed staying the impugned order. Therefore, as on today, we do not find any justification for permitting the third Director to be appointed. If and when the Committee decides to convene the meeting by the investors, it is open to move the Company Law Board for appointment of third Director.

19. For the smooth functioning of the company learned Senior Counsel appearing for both the parties submitted a right to cast a vote may be conferred on the Administrator, in the event of any deadlock.

20. Under these circumstances, we do not see any justification to appoint Mr. M.R. Gopinath as the advisor. The order passed by the Board replacing the Board of Directors is hereby set aside. Learned Administrator and the Directors, who are already on Board and who are running the administration could continue to run the business. Having regard to the nature of business itself between the parties, it is a fit case where the Company Law Board should take up the main matter out of turn and dispose of the petition itself expeditiously including the application filed invoking Section 8 of the Arbitration and Conciliation Act, 1996 and pass appropriate orders at the earliest.

21. As the application under Section 8 of the Arbitration and Conciliation Act is already pending, it will be appropriate to decide the application as expeditiously

as possible. If the application is to be allowed the entire petition would go out of jurisdiction of the Company Law Board. The said application is to be disposed of within a period three months from the date of communication of this order. With the above observations this companies appeal is disposed of. All the pending I.As. are ordered to be filed.