

(1978) 10 KL CK 0003

In the High Court Of Kerala

Case No : Application No. 272 of 1978 connected with Company Application No. 239 of 1977 in Company Petition No. 11 of 1976

P. Appunny

APPELLANT

Vs

The Star Tile Works Limited (In Liquidation) and Others

RESPONDENT

Date of Decision : 16-10-1978

Acts Referred:

Companies Act, 1956 — Section 391(2), 454(2)

Citation : (1979) 1 ILR (Ker) 463

Hon'ble Judges : G. Viswanatha Iyer, J

Bench : Single Bench

Advocate : M. Ramanatha Pillai, Mani J. Meenattoor, C.M. Devan, N.K. Sreedharan, M.C. Gopi and Government Pleader, T.V. Ramakrishnan, for the Appellant;

Judgement

G.Viswanatha Iyer, J.—Star Tile Works Ltd., Kallai, Calicut, was ordered to be wound up by an order of this court dated July 23, 1976, passed in C.P. No. 11 of 1976. The company itself had moved for such an order as it found that it was unable to pay its debts. Besides some secured creditors there is a large number of unsecured creditors among whom are the employees of the company to whom arrears of salary/wages, provident fund and gratuity are due. With the order for winding up all these employees were thrown out of employment and as a result their families have lost the means of their livelihood. The majority of these employees wanted to make an honest attempt to restart the company and for that purpose contacted an expert in the line to find out how the company can restart and carry on its business. After making the necessary investigations and enquiries a project report was prepared by that expert and handed over to the group of workers who contacted him. These workers also contacted the major creditors and shareholders to find out whether the creditors will be willing to accept the payment of a lesser sum and that over a period after the restart of the company. It seems the creditors were very reasonable and agreed to wait for some time and to receive a sum lesser than due in full satisfaction. The major

shareholders were also willing to assign their shares in favour of those workers who have come forward to make an effort to restart the company. On these a scheme was prepared to reconstruct the company and by Application No. 239 of 1977 filed u/s 391 of the Companies Act, the applicant, an employee, moved for an order to convene a meeting of the creditors and shareholders. By order dated 20th July, 1977, the official liquidator was directed to prepare a list of the creditors, secured and unsecured, of the company as disclosed by the books taken charge of by him. He submitted a list on 18th August, 1977. The list contains the names of five secured creditors and 50 unsecured creditors to whom amounts are shown as due in relation to the business dealings of the company. Besides them, the list also contains the names of three directors to whom money is due. The names of workers and staff to whom an amount is due from the company as gratuity, wage arrears and salary arrears are also mentioned in the list. Since the amount due to these employees was not specified, by order dated November 3, 1977, the liquidator was directed to file a statement showing the amounts due to them. Such a statement with the list was filed by the liquidator on November 24, 1977. A members' list was also submitted by the liquidator along with the creditors' list. By my order dated January 6, 1978, a separate meeting of the creditors and members was directed to be held at the registered office of the company at Calicut on March 18, 1978, to consider the scheme submitted to the court for sanction. By the same order Mr. P.K. Varghese, Advocate, was appointed chairman for both the meetings. Both the meetings were held, as ordered, on March 18, 1978, and two reports of the result of the meeting have been filed by the chairman. It is stated in the report that slight modifications were suggested at the meeting and they were passed. The scheme, as amended, was unanimously approved by the creditors and the members and the reports contain a full text of the amended scheme which was passed by the creditors and the members.

2. Thereafter, the applicant moved Company Application No. 272 of 1978 for an order to sanction the scheme. Notice of the application was given to the liquidator, the Registrar of Companies and also to the Central Govt. as required by s: 394A of the Companies Act. Notice of the hearing of the application was also published in the Mathrubhoomi daily dated 30th June, 1978, and Desabhimani dated 29th June 1978. The Regional Director, Company Law Board, Madras, representing the Central Govt., submitted that the Central Govt. has no comments to make on the request of the applicant. The official liquidator filed a detailed statement pointing out the financial position of the company as required by the proviso to Section 391(2) of the Companies Act. Along with that statement, the auditors' report and the balance-sheet as on the date of the winding up has also been filed. The question for consideration is whether sufficient grounds have been made out to sanction the scheme for the reconstruction proposed.

3. Proviso to Section 391(2) casts a duty On the court to see that all material facts relating to the company such as the latest financial position of the

company, latest auditors' report on the accounts of the company are disclosed by the company or the person who made the application. The court must also be satisfied on the materials disclosed that the scheme of reconstruction is in the best interests of the company, its members and creditors. In my order dated 20 July, 1977, I had reserved for consideration the question whether the company which has been ordered to be wound up can be revived and whether the court has got power to do it. Except Section 466, I do not find any specific provision in the Act for that. Section 466 is in the following terms:

466. Power of court to stay winding up.--(1) The court may at any time after making a winding-up order, on the application either of the official liquidator or of any creditor or contributory, and on proof to the satisfaction of the court that all proceedings in relation to the winding up ought to be stayed, make an order staying the proceedings, either altogether or for a limited time, on such terms and conditions as the court thinks fit.

(2) On any application under this section, the court may, before making an order, require the official liquidator to furnish to the court a report with respect to any facts or matters which are in his opinion relevant to the application.

(3) A copy of every order made under this section shall forthwith be forwarded by the company, or otherwise as may be prescribed, to the Registrar, who shall make a minute of the order in his books relating to the company.

4. This provision has been invoked by the applicant by his Application No. 650 of 1976 and, as a matter of fact, that is the first application which he filed before he applied for a direction to convene a meeting of the creditors and members. This provision enables the court to stay all proceedings in relation to winding up either altogether or for a limited time. By the order for winding up, a company does not cease to exist. That would happen only by an order for dissolution. Such an order has not been passed in this case. No steps have so far been taken by the liquidator to proceed with the winding up because the directors of the company have not yet filed the statement of affairs as required u/s 454(2) of the Act. A power to stay proceedings altogether or for a limited time necessarily implies a power to permit the company to carry on its business as if the winding-up order is not passed. I have passed such an order in the connected Application No. 650 of 1976. It follows that there is no impediment to consider the legality and feasibility of the scheme placed before court for sanction. I am supported in this conclusion by the decision of the Orissa High Court in *State of Orissa v. Official Liquidator* [1966] 2 Comp L. J. 31, where, in similar circumstances, the winding-up order of a company was stayed.

5. In considering whether sanction should be accorded to a scheme for reconstruction, the principle to be followed has been laid down in a number of cases. The leading case on the subject is *In re Alabama, New Orleans, Texas and Pacific Junction Railway Company* [1891] 1 Ch 213 (CA). Lindley, Lord Justice, stated the principle thus at page 239:

The Court must look at the scheme, and see whether the Act has been complied with, whether the majority are acting bonafide, and whether they are coercing the minority in order to promote interests adverse to those of the class whom they purport to represent; and then see whether the scheme is reasonable one or whether there is any reasonable objection to it, or such an objection to it as that any reasonable man might say that he could not approve of it.

6. This principle was again endorsed by the same learned judge in *In re English, Scottish and Australian Chattered Bank* [1893] 3 Ch 385 (CA). At page 408 the above quotation has been cited with approval. The learned judge further said (pp. 408 & 409):

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

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

7. Referring to these cases Maugham, L.J. in *In re Dorman Long and Company Ltd.* [1934] 1 Ch. 635 (ChD) has stated the principle to be applied by the court in the matter of approving the scheme or arrangement. According to him what the court has to see is whether the proposal is such that an intelligent and honest man, member of the class concerned and acting in respect of his interest might reasonably approve. The principles laid down in these decisions have been followed in India interpreting the provisions of Section 153 of the Indian Companies Act, 1913, corresponding to Section 391 of the present Act. In *In re Katni Cement & Industrial Co. Ltd.* [1937] 7 Comp. Cas 348 (Bom), Rangnekar J. stated the principle thus (pp. 363-4):

In my opinion, the scheme is fair and reasonable, put forward bona fide, and accepted by a very large majority of all classes of shareholders who have been acting honestly and bona fide on sufficient and detailed information and with plenty of time to consider what they are about. The test of reasonable compromise or scheme is whether it is regarded by reasonable people conversant with the subject as beneficial to those on both sides who are making

it.

8. In In the matter of Bharati Central Bank Ltd. ILR [1949] Cal. 127, Das J. has stated the principle thus:

The authorities clearly indicate that the Court has to ascertain and be satisfied as to several matters, the principal items of which are :--

- (1) Whether the provisions of the statute have been complied with ?
- (2) Whether the scheme is a reasonable and practical scheme or there is any reasonable objection to it ?
- (3) Whether, in approving the scheme, the creditors or shareholders had sufficient information and acted honestly and in good faith ?
- (4) Whether considerations of public interest ought, in the opinion of the Court, to override the decision of the creditors or shareholders ?

9. Again in In Re: Hindusthan General Electric Corporation Ltd., , Himamsu Kumar Bose J. has affirmed the above principles and also pointed out that the onus of proving the unreasonableness or unfairness about the scheme or want of good faith is on those who object to the sanction of the scheme. In the light of these the question for consideration is whether the statutory provisions contained in Section 391 of the Companies Act have been complied with in placing the scheme for sanction before the court and, secondly, the scheme is fair and reasonable for the court to accept. The scheme has been placed before the meeting of the creditors and of the members for their consideration. The members have unanimously approved the scheme and the creditors have also approved the scheme unanimously. That scheme is in the following terms:

(1) That the former managing director and his relatives, who together hold 6,000 out of the total 8,000 equity shares, have agreed to sell those shares to the workers and other employees of the company who agree to purchase these shares at the face value of Rs. 15 per share. The total value of these shares is Rs. 90,000.

(2) The workers and other employees of the company are getting 4 lakhs from the Provident Fund Commissioner by way of provident fund amount due to them and out of the same an amount of about Rs. 2 lakhs will be utilised for the purchase of shares and for the working capital.

(3) Regarding the repayment of the debts agreed to by the major creditors it will be settled as follows :--

(a) Out of the amount of Rs. 7 lakhs due to Prahladrey Maganlal and Sons, the creditors agree to receive in full satisfaction of their claim an amount of. Rs. 2,50,000 within two years from the date of commencement of the company's business.

(b) Kanthilal & Co., to whom an amount of Rs. 2,13,000 is due under a

mortgage, agree to accept payment of the amount within three years after the restarting of the business and the amount of Rs. 2 lakhs will carry future interest from the date of sanctioning of the scheme of arrangement by the court and the company undertakes to pay the same charged on the mortgaged properties;

(c) Smt. Premalatha Ramakrishnan, to whom an amount of Rs. 65,000 is due from the company under a decree, agrees not to demand payment of the money for two years from the date of the restarting of the business.

(d) Sri. Gopalankutty Menon, to whom an amount of Rs. 6,000 is due from the company under a decree, agrees that he will not demand payment of the amount till the factory restarts work and earns profit.

(e) Regarding the liability of about Rs. 5 lakhs due by way of provident fund, Employees' State Insurance, sales tax, Income Tax and corporation tax on reconstruction of the company, the company undertakes to pay the same and the said creditors agree to receive the said amount from the company on the reconstruction of the company and to relieve the former directors of the company from all liability for the payment of the same. The liability of the previous management on the above accounts will stand waived and the criminal prosecution and other proceedings pending against them will be withdrawn.

(f) The workers who take up the new management on the reconstruction of the company undertake to pay the other debts, if there is any.

10. Under the scheme the secured creditors have agreed to receive lesser sum in full satisfaction of the amount due and that after a period. The managing directors and their relatives have agreed to transfer their shares to the workers who have come forward to purchase them and to provide a working capital to restart the company. The only reason which influenced the board of directors to move the court to wind up the company was that they are unable to pay the debts which exceed the assets. Now that the creditors have agreed to wait for a fairly reasonable period to claim the amount due to them and have also agreed to receive lesser sum in full satisfaction, the creditors' pressure on the company is to a large extent reduced. If in this background a new set of office bearers who depend on the working of the company to earn their livelihood are inducted there is every reason to assume that they will be enthusiastic enough to work the company to the interest of all concerned. The assets disclosed by the balance-sheet is only the book value of the assets after depreciation. The actual value now will be very much more. The project report filed along with the application gives an encouraging picture regarding the possibility of the working of the company and the company earning profit which, if properly utilised, will be available for discharge of the debts. I am referring to these only to show that the shareholders and the creditors have approved the scheme and the scheme appears to be fair and reasonable.

11. No doubt the financial position of the company as disclosed by the latest auditors' reports and the accounts of the company show that the liabilities

exceed the assets. The value of the assets shown in the auditors' report is not their present value, but their book value after depreciation. As stated earlier, the actual value will be very much more than the value shown in the report. Since the creditors--secured and unsecured--as shown in the approved scheme have agreed to wait for a period and to be satisfied with a lesser amount such of those creditors referred to in the scheme will be bound to receive only as stated in the scheme. The only creditors who have not agreed to wait and to receive lesser sum are the Provident Fund Commissioner, the sales tax authorities and the employees. Now that the major creditors referred to in the scheme will not immediately press for their amounts, it will be possible for the company to pay off the provident fund liability and sales tax liability. It follows that the financial position of the company under the scheme will not be as bad as it is now. It is necessary that a fair trial must be given to the working of the scheme. If the scheme is successfully worked a large number of the employees and their families also stand to gain. Certainly this is also in the public interest.

12. Before I close this part, I have to very regretfully observe that the Regional Director, Company Law Board, and the Registrar of Companies to whom notices were issued are indifferent in this matter. If the Registrar of Companies had properly looked into the working of the company periodically, it would have been possible for him to save the company from its present predicament. It looks as though the Registrar is satisfied with some statutory returns and fees for them. I do not understand that this is all the function of the Registrar under the Companies Act. I expected some assistance from the Registrar and the Regional Director of the Company Law Board in the matter of considering whether the scheme is fair and reasonable and whether it can be worked ; what are the hurdles which may have to be got over, what are the difficulties which one has to anticipate in restarting the company, these are all matters on which the above authorities could have rendered assistance. Their indifference in this matter is highly regrettable. I have been noticing this indifferent attitude on their part not only in this case, but in almost all the companies which have now gone into liquidation. The regulatory function of the Registrar and the Company Law Board does not stop with calling for some returns and the fees for them. If the balance-sheet and the auditors' reports are looked into from time to time by these authorities they could find out whether the companies are working satisfactorily and if they are not so working it is the duty of these authorities to take appropriate action in the matter. Their inaction at the relevant time and their indifference in not placing the various aspects which have to be looked into before the court sanctions the scheme do not commend to the court.

13. In the result the scheme referred to above is sanctioned.

14. u/s 392, the court has got power when sanctioning the scheme to supervise the carrying out of the scheme and to give such directions in the matter as it may consider necessary. Since in the connected Application No. 650 of 1976 the proceedings in relation to the winding up have been stayed for a period of six

months, the board of directors as on the date of the winding-up petition will continue to act as the board of directors to manage the affairs of the company until the new board is elected. An affidavit has been filed on 3rd October, 1978, on behalf of the existing board of directors that they are willing to act as the board of directors and function as such in the matter of registering the transfer of shares proposed under the scheme. Most of the workers have contributed to a fund for the purpose of purchase of shares from the managing directors and their relatives and to provide a minimum working capital. An affidavit has been filed on October 5, 1978, by the applicant mentioning that the shares will be purchased by the workers in the ratio in which they have contributed to the fund. It will be open to the workers who purchase the shares to elect the new board of directors within a period of three months. The directors so elected will, within the prescribed period, acquire the necessary qualifications by having the necessary number of shares for being qualified to be elected as directors. After the new board comes into being it will be open to them to take charge of the assets now in the custody of the liquidator and work the company as per the scheme sanctioned. In the course of the working of the company if it becomes necessary to raise a loan or encumber any of the fixed assets sanction of this court will be obtained by the new board. The new board of directors will also take appropriate directions from the court in the matter of working of the scheme. Before the expiry of the period of stay now granted it will be open to the new directors to move for extension of stay u/s 466. The new board will engage all the staff and workers in the employment of the company on the date the application to wind up was filed. If any of them does not come forward to work, the new board will take appropriate orders from the court to remove them. The staff, workers and other employees of the company will not be eligible for any emolument by way of salary, wages or otherwise for the period from the commencement of the winding up till the company restarts its business. Subject to the above directions, Application No. 272 of 1978 is allowed. There will be no order as to costs.

15. A certified copy of this order shall be filed by the applicant with the Registrar within three weeks from today.