(1995) 09 KAR CK 0032

In the Karnataka High Court

Case No : Original Side Appeals No''s. 3 to 6 of 1995

Webb''s Farm Mechanization (P.) Ltd. and others APPELLANT

Vs

Official Liquidator and another RESPONDENT

Date of Decision : 28-09-1995

Acts Referred:

Companies Act, 1956 — Section 391, 394, 484

Citation : AIR 1996 Kar 65 : (1999) 97 CompCas 956 : (1995) ILR (Kar) 2991 : (1995) 5 KarLJ 608

Hon'ble Judges : M.L. Pendse, C.J;H.N. Narayan, J;A.J. Sadashiva, J

Bench : Full Bench

Advocate : B. Gopalaiah, for the Appellant; S.M. Chandrashekhar and Ashok Harnahalli, for the Respondent

Judgement

M.L. Pendse, C.J.—The question which falls for consideration in these appeal referred to the Full Bench is of application of the second proviso to sub-section (1) of section 394 of the Companies Act, 1956 (hereinafter referred to as "the Act"), on application made u/s 391 of the Act for amalgamation of two companies where the order is to be passed for dissolution without winding up of the transferor-company.

2. Webb''s Sales and Service (P.) Ltd., Webb''s Farm Mechanization (P.) Ltd., Webb''s Agricultural and Automobile Industries (P.) Ltd., Webb''s Agricultural and Automobile Service (P.) Ltd. and Webb''s Method Manufacturing (P.) Ltd. (in liquidation) are companies comprising Webb''s group of companies. The directors of all the companies are the same persons and the governing director on fall the group companies is Mrs. Shirley Webb. Mrs. Webb and her children are the shareholders of the companies. Webb''s Method Manufacturing (P.) Ltd. was incorporated on September 2, 1985, but in view of the termination of contracts for truck and bus body building the company was running into losses and in March, 1992, the company passed a resolution for voluntary winding up as prescribed u/s 484 of the Act. Mrs. Webb was appointed liquidator. The liabilities

of the company at the relevant time were to the tune of Rs. 62 lakhs while the cash balance and book debts were to the extent of Rs. 5 lakhs. The machinery and the structure of the company were mortgaged to the Karnataka State Finance Corporation.

3. Webb''s group of companies thereupon decided that to avoid liquidation of the company in voluntary liquidation and to save the prestige of the Webb''s group, the five companies including the one under voluntary liquidation should be amalgamated. The object of amalgamation was to pay off all outside creditors in full and wiping off all the debts of the company in liquidation. The scheme of amalgamation provided that the four companies would be amalgamated in Webb''s Sales and Service (P.) Ltd. and the amalgamated company will take over all the assets and liabilities of the remaining four companies. After amalgamation, the amalgamated company would have surplus assets of over Rs. 6 crores.

4. The requisite resolutions were passed by the boards of directors of all the companies, and on October 28, 1993, Company Application No. 449 of 1993 was filed before the company judge u/s 391 of the Act for sanction of the scheme. The company judge directed that meetings of the shareholders be convened and after approval was secured for the scheme at the meetings, the company judge was moved for sanctioning the scheme. On June 2, 1994, statements were filed on behalf of the companies claiming that the scheme provides for amalgamation and taking over of four companies including the one in liquidation and a direction for dissolution of the three transferor-companies is not required.

5. The company judge notified the Registered of Companies, the Company Law Board and the official liquidator about the proposed scheme. On July 5, 1994, the official liquidator made report No. 78 of 1994, to the company judge pointing out that an order for dissolution of the transferor-companies under clause (iv) of sub-section (1) (b) of section 394 of the Act cannot be passed unless the official liquidator, on a scrutiny of the books and papers of the transferor-companies, makes a report that the affairs of the transferor-companies have not been conducted in a manner prejudicial to the interests of the members or to public interest. The official liquidator requested the company judge to issue directions for such scrutiny and claimed that an amount of Rs. 10,000 should be deposited towards charges of the chartered accountant required for scrutiny of the books and papers of the companies. The transferor-companies objected to the claim of the official liquidator that the company judge is required to pass an order for dissolution of the transferor-companies before sanctioning of the scheme. The companies also claimed that the report of the official liquidator under the second proviso to sub-section (1) of section 394 of the Act is not necessary. The company judge, by impugned order dated November 8, 1994, accepted the claim made by the official liquidator in view of the decision of the A.D. Chaudhary Vs. Mysore Paper Mills Ltd., The company judge held that there can be no dissolution of any transferor-company without winding up unless the official liquidator has

made a report after scrutiny of the books and papers of the company. The company judge noticed that such report is required only in respect of those companies which are not under liquidation and which are sought to be merged with the other company. As far as the company under liquidation was concerned, response was not received from the Company Law Board or the Register of Companies in spite of notifying those authorities under the first proviso to sub-section (1) of section 394 of the Act. The company judge, therefore, directed the official liquidator to file the report in respect of the three transferor-companies.

6. The order of the company judge passed in Company Petition Nos. 68 to 72 of 1994 is under challenge in this batch of appeals. The appeals were posted for hearing before a Division Bench on July 7, 1995. The Division Bench expressing doubt about the correctness of the view of the Division Bench in the case reported in A.D. Chaudhary Vs. Mysore Paper Mills Ltd., referred the appeals to the Chief Justice for constituting a larger Bench. The appeals are accordingly placed for disposal before this Bench.

7. Section 391 of the Act entitles the court to sanction any compromise or arrangement between a company and its creditors or between a company and its members. The section authorises the court to sanction the scheme even without the company first being wound up. The section was amended in the year 1965 in pursuance of the recommendation of the Daphtary-Sastri Committee Report which, inter alia, provided that before the company court proceeds to sanction the arrangement or amalgamation, information as to important facts should be made available and for that purpose, notice of every application for the scheme of amalgamation should be served on the Registrar of Companies. The relevant part of section 394 of the Act reads as follows :

''394. Provisions for facilitating reconstruction and amalgamation of companies. - (1) Where an application is made to the court u/s 391 for the sanctioning of a compromise or arrangement proposed between a company and any such persons as are mentioned in that section, and it is shown to the court -

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

(b) that under the scheme, the whole or any part of the undertaking, property or liabilities of any company concerned in the scheme (in this section referred to as a "transferor-companies") is to be transferred to another company (in this section referred to as "the transferee-company");

the court may, either by the order sanctioning the compromise or arrangement or by a subsequent order, make provision for all or any of the following matters :-...

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

Provided further that no order for the dissolution of any transferor-company under clause (iv) shall be made by the court unless the official liquidator has, on scrutiny of the books and papers of the company, made a report to the court that the affairs of the company have not been conducted in a manner prejudicial to the interests of its members or to public interest.''

8. A plain reading of sub-section (1) of section 394 of the Act makes it clear that when an application is made to the court u/s 391 for sanction of a scheme of amalgamation the court, while sanctioning the scheme or by subsequent order, should make provision for dissolution, without winding up, of the transferor-company. The provisions of sections 391 and 394 of the Act are to be read together, and section 391 confers power upon the company court to sanction the scheme while section 394 sets out the procedure to be followed. A plain reading of the second proviso to sub-section (1) of section 394 of the Act makes it clear that no order for dissolution of any transferor-company shall be made by the court unless the official liquidator has, on a scrutiny of the books and papers of the company, made a report that the affairs of the company are not conducted in a manner detrimental to the interests of the shareholders or to the general public.

9. It was contended on behalf of the appellants that the order of dissolution without winding up of the transferor-company is not required as the scheme for amalgamation prescribes for merger of the transferor-companies with the transferee-company. The contention that the order of dissolution under clause (iv) of sub-section (1) (b) of section 394 of the Act is not required is not correct. The scheme of amalgamation is bound to provide for merger of the transferor-company with the transferee-company, but such merger cannot take effect without the transferor-company being dissolved. An amalgamation is not possible without dissolution of the transferor-company. Where the two companies are proposed to be amalgamated into a new company, though the scheme may not involve the winding up of the respective companies, it does involve the dissolution and, consequently, a report by the official liquidator as contemplated by the second proviso to sub-section (1) of section 394 of the Act would be necessary.

10. The Division Bench of this court, in the case of Mysore Galvanising Co. [1976] 46 Comp Cas 639 after examining the two provisos to sub-section (1) of section 394 of the Act, observed (at page 642) :

"It is plain from the above analysis of the two provisos that the said provisos deal with different situations, in that while the first proviso relates to the sanction of a compromise or arrangement involving a scheme of amalgamation of a company ''which is being wound up'', the second relates only to an order for dissolution of a transferor-company without winding up. It is no doubt true that a single scheme of amalgamation or reconstruction in a given case may involve both types of companies, namely, those under winding up and those which are not, one or more of the latter category coming in for dissolution. In such a situation both the provisos come into operation. On the other hand, there may be cases where, as in the instant case, no company which is under winding up may be involved. In such an event, the first proviso does not come into play at all and only the second proviso will be operative. This is not the same as saying that the second of the provisos would come into operation only when the first proviso operates, as contended for the respondent-companies."

11. We are in agreement with the view expressed by the Division Bench. This view was also adopted by a Division Bench of the Calcutta High Court in the case reported in Regional Director, Company Law Board, Calcutta v. R. K. Investments [1978] Tax LR 1885 . Mr. Justice A. N. Sen, as he then was, while speaking for the Bench, observed that the Legislature in its wisdom has thought it fit to make a special provision in the case of an order for dissolution without winding up of any transferor-company and it is fallacious to suggest that the second proviso to sub-section (1) of section 394 of the Act has no application if the transferor-company is not in the process of being wound up. The Division Bench held that a company which is a going concern may choose for various reasons to amalgamate itself with another company and in such a case an order for dissolution without winding up of the company is required to be made. The Division Bench of the Calcutta High Court disapproved the decision of a single judge in In Re: Marybong and Kyel Tea Estate Ltd., and expressed agreement with the view taken by the Division Bench of this court in Mysore Galvanising''s case [1976] 46 Comp Cas 639 Mys . A single judge of the Bombay High Court in In Re: Sumani Pvt. Ltd., approved the view of the Division Bench of this court in Mysore Galvanising''s case [1976] 46 Comp Cas 639 Mys and disagreed with the view of the learned single judge of the Calcutta High Court in In Re: Marybong and Kyel Tea Estate Ltd., In our judgment, the view taken by the Division Bench of this court as well as the Division Bench of the Calcutta High Court and the single judge of the Bombay High Court is the only view possible on a plain reading of the second proviso to sub-section (1) of section 394 of the Act and it is not possible to appreciate why the Division Bench felt considerable doubt about the correctness of the view. The reference order does not set out any reason for the doubt felt by the Division Bench.

12. The object of calling for the report of the official liquidator is to satisfy company court that the interests of the shareholders and public interest are not prejudicially affected by the amalgamation. We are unable to appreciate why the report of the official liquidator should be dispensed with merely because the appellants claim that the scheme of amalgamation provides for merger of transferor-companies and the order of the company judge for dissolution without winding up of the transferor-companies is not required.

13. Section 448 of the Act provides for the appointment of an official liquidator for each High Court. The submission that the official liquidator u/s 448 is appointed so far it relates to the winding up of the companies by the court and the official liquidator has no role to play when the transferee-company is not wound up is not correct. The principal function of the official liquidator is undoubtedly in relation to the winding up of the company, but that cannot lead to

the conclusion that the official liquidator has not existence for any other purpose of the Act. Section 448 merely prescribes the manner and mode of appointment of the official liquidator and once such an appointment is made by the Central Government then, it is open to clothe the official liquidator with any other duty which the Legislature considers expedient and necessary. The second proviso to sub-section (1) of section 394 of the Act demands submission of the report from the official liquidator in cases of dissolution of the company without winding up and we are unable to appreciate how it can be claimed that the official liquidator does not come into the picture unless the transferor-company is being wound up. The first proviso to sub-section (1) of section 394 deals with the transferor-company which is being wound up while the second proviso deals with a transferor-company which is to be dissolved without being would up. The two provisos are attracted to different sets of circumstance. In our judgment, the impugned order passed by the company judge calling upon the official liquidator to file a report under the second proviso to sub-section (1) of section 394 of the Act in respect of the transferor-companies which are not in liquidation is correct and does not suffer from any infirmity. The appeals, therefore, are devoid of any merit.

14. Accordingly, all the appeals are dismissed, but without any order as to costs.

