

Shri Kumar Malavalli Vs. Crcw Search Technologies Private

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Court : Company Law Board CLB

Decided On : Jun-23-2003

Reported in : (2004)118CompCas618

Judge : K Balu

Appellant : Shri Kumar Malavalli

Respondent : Crcw Search Technologies Private

Judgement :

1. This petition is filed under Section 111 of the Companies Act, 1956 ("the Act") against M/s. CRCW Search Technologies Private Limited ("the Company") for rectification of the register of members of the Company in respect of 2000 shares of Rs. 100 covered under share certificate No. 5 by cancelling the allotment of share said to be made in gross violation of the provisions of the Act, in favour of the Petitioner.

2. According to Shri. Parameswaran, Advocate appearing for the petitioner, the petitioner is a Non-Resident Indian residing at California, US and well known entrepreneur in the information technology business. The petitioner used to extend financial assistance of his friends and relatives in establishment of companies and promotion of business in India. Accordingly, the petitioner had remitted funds to the tune of US\$ 4,70,000 on 7.4.2001 in favour of one (SIC) Srikanth Nagaraja (SN) on his request, who was introduced by Prof. Akilesh (SIC) Indian Institute of Science, for incorporation and promotion of the Company. The amount was

remitted in the personal name of SN through normal banking channels and SN was the beneficiary, as seen from the certificate of foreign inward remittance dated 7.4.2001 (page 13 of petition). However the funds remitted in favour of SN for the development of information technology business were misutilised by allotting 200 equity shares of Rs. 100 each, aggregating Rs. 2,00,000/- at a premium of Rs. 2,15,65,400 to the petitioner on 22.11.2001 as per Form 2 dated 23.11.2001 (page 14 of petition) filed by SN in his capacity as director of the Company, without consent and knowledge of the petitioner. Shri Parameswaran strongly contended that the petitioner has never agreed in writing to become a member of the Company and that the correspondence exchanged between the parties do not show that the petitioner had agreed to become a member in the Company, satisfying the statutory requirement of Section 41(1). The petitioner had neither agreed for the allotment of the impugned shares in his favour at a premium of Rs. 10,782.70 per share. The premium was fixed without the knowledge and consent of the petitioner. But the petitioner's name was stealthily entered in the Register of Members of the Company. The petitioner, therefore, cannot be deemed to be a member of the Company. Shri Parameswaran in support of his legal submissions relied upon the following decisions:Rahul Subodh Windoors Limited v. K. Menon and Anr. - 1999 (96) Comp. Cas. 539 (SC) - to show, interalia that allotment can be made to a persons who becomes a member of the company when an application is made to that effect.

* Ram Kishan v. Kanwar Paper Private Limited - 1990 (69) Comp. Cas.

209 (HP) - to show that the incorporation of the name of any person in the register of members of a Company without thee being any agreement on his part "in writing" is contrary to the statutory requirements of Section 41(2).Indglonal Investment and Finance Limited v. Rajasthan Breweries Limited - 2001 (107) Comp. Cas. 525 (CLB) - to show that Section 41 of the Companies Act, 1956 stipulates that a person, to become a member, should agree in writing ... Non-compliance with the provisions of law is a sufficient cause to order rectification of register of members.

Moreover under the relevant provisions of the Foreign Exchange Management (Transfer or issue of Security by a Person Resident Outside India) Regulations, 2000 ("FEMR"), any shares issued to persons resident outside India, by a company which is not listed on any recognized stock exchange in India, the price of shares should not be less than fair valuation of shares done by a Chartered Accountant as per guidelines issued by the erstwhile Controller of Capital Issues. A company in India issuing shares to a person resident outside India should receive amount of consideration for such shares by inward remittance through normal banking channels or by debit to NRE/FCNR account of person concerned maintained with an authorised dealer/authorised bank. In the present case there is no direct remittance of funds from the petitioner in favour of the Company. The petitioner did not agree in writing for transferring any amount sent to SN, in favour of the Company towards allotment of shares in favour of the petitioner. Shri Parameswaran, therefore, urged that the issue of impugned shares in favour of the petitioner is in gross violation of the provisions of FEMR. For these reasons Shri Parameswaran sought for the reliefs made in the petition.

3. According to Ms. Chitra Narayanan, Advocate appearing for the Company, SN had in the year 2000 conceived of a hardware database accelerator card, enhancing the performance of operations in computers, prepared with Prof. Akhilesh, a draft business plan for development and application of the concept and approached the petitioner while he was in Bangalore in early December, 2000 for funding the said project. The parties had negotiated through out the period from 2000 to 2002 in regard to the incorporation of the Company, investment in shares of the Company etc. After mutual discussions from time to time either in person or through correspondence, the business plan was among other things, approved by the petitioner to fund the project, incorporate respondent Company; distribute shares between the petitioner, SN and others in terms of the term sheet etc. In this connection, learned Counsel for the Company referred to the various correspondences exchanged between the parties both prior to and after incorporation of the Company (pages 1-81 of Counter). By virtue of these correspondence, the petitioner had agreed in writing to subscribe to the shares of the Company, upon which an amount of US\$ 4,70,000 was remitted by the petitioner. The correspondence exchanged between the petitioner and SN would

by way of conduct amount to and are in nature of agreement in writing on the part of the petitioner to become a member of the Company satisfying the requirement of Section 41(1) compliance of which is not a mandatory requirement. Accordingly the respondent Company was incorporated on 23-04-2001 with SN and one Shruthi Akhilesh, as the first directors of the Company. The investment made by the Petitioner was utilised in the incorporation and promotion of the Company by SN. The petitioner had sent the remittance in the name of SN, as the Company was yet to (SIC) incorporated by then.

M/s. Chitra Narayanan in support of her legal submissions in regard to the interpretation of Section 41(1) has referred to the following decisions:- * Shri Balaji Textile Mills Private Limited and Anr. v. Ashok Kavle and Ors. (1989) Vol. 66 Comp. Cas. 654 to show that "the underlying purpose of Section 41(2) is that a person must give his consent in unequivocal terms by applying in writing for allotment of shares.

But it does not mean that the company cannot allot the shares even when a person has not complied with the requirement of Section 41(2) of the Act. Compliance with the provisions of Section 41(2) of the Act is not a mandatory requirement but only directory.

Allotment of shares is a matter of contract between the parties and that contract could be either express or implied. If a person is treated as a shareholder of a company, his right of membership cannot be questioned by the company on the ground that he has not complied with Section 41(2) of the Act".

* Srikanta Datta Narasimharaja Wadiayar v. Venkateswar Real Estate Enterprises (Private) Limited and Ors. - (1990) Vol.68 Comp.Cas.216, wherein the principles enunciated in Shri Balaji Textile Mills Pvt.

Ltd., cited supra are followed. Master Gautam R. Padival (Minor) v. Karnataka Theatres Limited - (2000) Vol.100 Comp. Cas. 124 to show that the provisions of Section 41(2) are not mandatory, but only directory and that to become a member it is not always necessary that one should agree in writing.

Ms. Chitra Narayanan therefore contended that it cannot, be construed that the petitioner had made the remittance for business development and for the benefit of SN without the allotment of impugned shares to the petitioner. Ms. Chitra Narayanan, while concluding her arguments reiterated that the impugned shares were duly allotted at premium to the petitioner with his knowledge and concurrence and, therefore, the petitioner cannot challenge the allotment and seek rectification of register of members of the Company. The decisions cited on behalf of the petitioner are inapplicable in the facts and circumstances of the present case.

4. I have considered the pleadings and submissions - oral and written - of Counsel for the petitioner and the Company. The issues that arise for my consideration are whether the register of members of the Company is required to be rectified by deleting the name of the petitioner in respect of 2,000 shares impugned in the petition and cancel the allotment in the facts and circumstances of the case.

5. It is on record that the petitioner, a non-Resident Indian entrepreneur in the Information Technology Business and resident of California, USA was evincing interest in the establishment of a software company at Bangalore, in course of which got introduced to SN with Technical background and exposure in information technology. The software business conceived by SN was discussed from time to time with the petitioner through exchange of correspondence and on a few occasions in person, whenever the petitioner was in Bangalore. The correspondence so exchanged in regard to the formation and conduct of the software business and produced before the Bench are not in dispute.

While according to the Company, the correspondence exchanged between the parties (Pages 1 to 81 of counter) would amount to and are in the nature of an agreement in writing on the part of the petitioner to subscribe to shares of the Company and become a member, in sufficient compliance with the requirement of Section 41(1), it is stoutly denied by the petitioner. Section 41(2) provides that for any person to become a member, two conditions must be fulfilled - (a) that there is an agreement to become a member and (b) that the name is entered in the register of members. It is, therefore, abundantly clear that no one can become a

member unless he has agreed in writing to become a member of the Company. In this context, the correspondence between the parties assume greater significance. The business plan contemplated at pages 1 to 6 of Counter speaks of the main activities, strategy, funding, estimated revenue from the business, shareholding pattern etc. over a period of time. The petitioner's shareholding is determined at 50 per cent during the phase 1 and 60 per cent during phases 2, 3 and 4. The term sheet (pages 7 to 10 of counter) contains, inter-alia, the broad understanding between the petitioner and SN to set up a green field Internet Server Software company, according to which, the petitioner would be an investor and SN one of the founders of the Company. The petitioner would invest in the Company to the tune of US \$ 1.27 million of which US \$ 0.47 million equivalent to Rs. 2,17,65,400/- by 15th July 2001. The communication dated 21.12.2000 of SN (Pages 13 - 14 of counter) addressed to the petitioner shows that the petitioner would send the money in the name of SN, which would be transferred to the Company at the time of formation. The petitioner had remitted in accordance with the term sheet US \$ 4,70,000 in favour of SN. The certificate of foreign inward remittance dated 07.04.2001 (Page 13 of petition) shows that the proceeds of the remittance were credited on 24.01.2001 to the account of SN. The purpose of remittance was for incorporation and promotion of the Company. Admittedly the Company was incorporated on 23.04.2001 and the remittance was made in the name of SN, (SIC) terms of the communication dated 21.12.2000 of SN, stated supra, The communication of SN not being disputed by the petitioner would establish that the monies were sent for incorporation of the Company and not for the benefit of SN. In the event of the Company not having been incorporated, the remittance could only be in the name of the promoter of the Company and in this case SN. There is nothing on record to show that the funds remitted by the petitioner in favour of SN would be returned by the latter and, if so, the terms of repayment, rate of interest etc. The plea of the petitioner that the funds were sent for the personal benefit of SN is not convencing. The correspondence at pages 18, 19, 23-37, 43-60 and 81 relating to the Memorandum and Articles of Association, receipt of the funds, constitution of the Board of Directors of the Company, requisition of business details, receipt and payment account, formalities in regard to patent registration and authority given to the petitioner's father and brother in relation to the affairs of

the Company would show that the petitioner had always intended to invest in the Company so as to carry on the software business with SN. These correspondence referred to in this paragraph, would indicate that the petitioner had agreed in writing to invest in the Company and that the petitioner would be issued shares of the Company at an appropriate and mutually agreeable premium, which in my view, is in compliance with the requirement of Section 41(1). In the circumstances, the case laws cited on behalf of the petitioner do not come to his rescue. Against this background, the plea of the Company that 2,000 shares of Rs. 100/- each were allotted on 22.11.2001 to the petitioner at a premium of Rs. 10,782.70 per share has to be considered. It is observed from Form-2 dated 23.11.2001 (Pages 14-15 of petition) filed by the Company before the Registrar of Companies and the communication dated 28.11.2001 of the Company (Page 71 of counter) addressed to the Reserve Bank of India that the impugned shares were allotted to the petitioner on 22.11.2001. Whereas, the minutes of the Board meeting held on 15.06.2001 reveal that the Board of Directors had decided to allot 2000 equity shares of Rs. 100/- each in favour of the petitioner at a premium of Rs. 18,782.70 per share subject to approval of the members at the extraordinary general body meeting. Accordingly, the allotment of 2,000 equity shares of Rs. 100/- each at a premium of 10,782.70 per share was approved in favour of the petitioner for a consideration of Rs. 2,17,65,400 at the extraordinary general body meeting of the members of the Company held on 25.06.2001.

Thereafter, the impugned shares were allotted in favour of the petitioner for a consideration of Rs. 2,17,65,400/- at the Board meeting held on 26.11.2001, which is found to be in variance with the stand taken by the Company that the shares were allotted to the petitioner on 22.11.2001. Moreover, the Company has not chosen to produce the minutes of the Board meeting held on 22.11.2001. This discrepancy has not been explained by the Company. There is also no explanation as to how the premium was arrived by the Board of Directors of the Company. Though correspondence between the petitioner, SN and the petitioner's brother during the relevant period (Pages 36, 37 and 66-68 of counter) speak of the investment pattern and business of the Company), surprisingly they do not make any reference to the purported allotment in favour of the petitioner. At this point of time, it is relevant to point out the specific plea of the Company that on

22.11.2001, the petitioner's brother along with one Mr. Ravi had forcibly removed, among other things, the computers and printers from the Company's office as revealed from paragraph 14 of counter and the Gate Pass dated 21.11.2001 at page 70 of counter. In spite of this alleged unlawful act at the instance of the petitioner's brother, the Company had claimed to have allotted the shares to the petitioners, which is quite improbable, especially when the minutes of the Board meeting said to held on 26.11.2001 do not indicate any such violence.

Moreover, the certificate dated 09.01.2002 of the Chartered Accountant of the Company (Pages 78 and 79 of counter) shows that the premium of Rs. 10,782.70 per share was arrived at by mutual agreement between the Company and the petitioner. However, there is no record either to substantiate any such mutual agreement between the parties or due compliance with the guidelines issued by the erstwhile Controller of Capital Issues in valuation of the impugned shares. In these circumstances, the allotment of impugned shares in favour of the petitioner appears to be irregular and not in consonance with the relevant provisions of FEMR, which would be a sufficient cause to order rectification of register of members of the Company. For these reasons, the Company is hereby directed to rectify the register of members and delete the name of the petitioner in respect of 2,000 shares impugned in the petition within 30 days from the date of this order.

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