

In Re: Firebricks and Potteries

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Court : Company Law Board CLB

Decided On : Mar-13-2008

Reported in : (2008)145CompCas106

Judge : K Balu

Appellant : In Re: Firebricks and Potteries

Judgement :

1. In the company petition filed under Sections 397 and 398 of the Companies Act, 1956 ("the Act") on account of certain acts of oppression and mismanagement in the affairs of M/s. Firebricks and Potteries Private Limited ("the Company"), the applicant-respondents have preferred the present application, challenging the maintainability of the company petition, for not meeting the requirements of Section 399, in support of which Shri R. Venkatavaradan, learned Counsel submitted:

- o By virtue of Section 399, a person seeking to invoke the jurisdiction of the Company Law Board under Section 397/398 should hold at least 10% of the shares as contemplated in Section 399(1)(a), whereas the respondent-petitioner holds 1.42% of share capital. The petitioner, therefore, does not have the requisite number of shares, to invoke the jurisdiction of the CLB.
- o The board of directors of the Company at the meeting held on 24.04.2006 had approved the issue of 32,500 10% redeemable cumulative preference shares (RCPS) of Rs. 100/- each at a premium of Rs. 400/- per RCPS on rights basis to the existing shareholders in the ratio of ten RCPS for every one equity share held by the members. The petitioner was entitled to 5,060 shares constituting 15.60% and he was required to pay Rs.

25.30 lakhs. The petitioner by his letters dated 19.05.2005 and 20.06.2006 requested for extension of time, but failed to exercise his option for the rights issue and therefore, cannot make a case of oppression and mismanagement of the affairs of the Company. These vital aspects have not been disclosed by the petitioner, throwing light on the conduct of the petitioner.

o The RCPS issued by the Company were subsequently converted into equity shares of Rs. 100/- with a premium of Rs. 400/- as approved at the extra ordinary general meeting of the members of the Company held on 20.09.2006. Consequently, the shares held by the petitioner came to be reduced from 15.60% to 1.42%, disqualifying him from applying under Section 397/398 of the Act. The petitioner has not challenged the issue of shares, whereas he asserts that 15% of shares is held by him, which is contrary to the materials on record. *Sangramsinh P. Gaekwad v. Shantadevi P. Gaekwad* larger interest of the Company; and (b) directors have acted in good faith, without misusing the fiduciary duties and without any ulterior motive on their part, the decision to issue shares cannot be struck down on the ground that it has incidentally benefited the directors in their capacity as shareholders. The statutory duty of a director is primarily to look after the interest of the Company and his fiduciary duty extends to the Company and not a shareholder. It was held in *T.N.K. Govindaraju Chetty v. Kadri Mills (CBE) Limited* (1999) Vol. 96 CC 871 that as long as the object is not to increase one's shareholding and reduce the holding of the minority then how the board decides to raise funds is for the board to decide, especially when the same is placed before the general body for its consideration and approval. The directors in the present case have been diligent in discharging their duties in favour of the Company.

The paid up capital of the Company accounted only for Rs. 3.25 lakhs, with losses of Rs. 75 lakhs and accumulated losses of Rs. 3.10 crores, as found reflected in the balance sheet for the year ended 31.03.2005. The Company has paid to Bangalore Mahanagra Palike huge sums of money towards development charges (Rs. 39.49 lakhs), and building tax (Rs. 12.57 lakhs) on account of the properties belonging to it, as borne out by the receipts issued by Bangalore Mahanagra Palike. The board of directors has the authority to allot shares at their discretion. Thus, the Company genuinely required additional funds for its purposes and the

further issue of shares is for the benefit and in the interest of the Company. The extra ordinary general meeting was held on 04.0.2006, after notice to the petitioner, wherein share capital was increased and the articles were amended. These developments were not disputed by the petitioner. The charges presently raised have not been taken by the petitioner in his communication dated 04.03.2006 sent in response to the notice of the extra ordinary meeting. The petitioner is aware of the increase in the authorized capital, as evidenced from the averments contained in the main petition to the effect that the present authorised capital is Rs. 80 lakhs. The petitioner has not questioned the validity of the extra ordinary general meeting and there is no prayer to set aside the extra ordinary general meeting held by the Company, but is challenging the issue of preference shares in the company petition. Nevertheless, the petitioner failed to plead that the shareholding of the petitioner got reduced below 10% on account of further issuance of shares.

o The action of the Company to convert preference shares into equity shares is not relevant for the purposes of Section 399. The notice of the extra ordinary general meeting discloses the business regarding the issue of preference shares and amendment of the capital clause of the memorandum of association of the Company. The explanatory statement appended to the notice of the extra ordinary general meeting speaks of the proposal of the board of directors to develop the existing property by building residential apartments to augment regular source of income. The Company, therefore, proposed to raise funds partly by issue of preference share capital. The directors report for the year ended 31.03.2006 states that the Company had issued cumulative preference shares for an amount of Rs. 1.37 crores at the instance of the lending Banks/Institutions to ensure participation of the directors/promoters in the share capital of the Company. The entire cost of development and construction in terms of the Joint Venture Agreement dated 20.06.2006 must be borne by the Developer, which would show the need for funds towards operations of the Company. These resulted on account of the subsequent developments and there is no inconsistency in the stand of the Company. The Company had issued only 27,440 preference shares of Rs. 100 each, whereas the petitioner is seeking to set aside 40,000 cumulative preference shares. The board having the authority offered on 24.04.2006 the additional

shares to its members. The petitioner did not choose to subscribe to the additional shares offered by the Company and therefore, the impugned allotment could never be to reduce the shareholding of the petitioner. Therefore, the issue of convertible warrants to the promoters cannot be held to be an act of oppression in the facts of the case.

o No preferential shares have been allotted to R.N. Shetty Family Trust as brought out by the addendum to auditors report the year ended 31.03.2007. Even otherwise, there is no prohibition to allot shares in the name of the Trust. The petitioner is aware of the fact that R.N. Shetty Family Trust is holding shares in the Company, but never challenged till initiating the present proceedings. The board minutes dated 12-12-2000 would show the allotment of shares in favour of R.N. Shetty Family Trust and the board minutes have been signed by the petitioner. However, 98.5% of shares are held in the name of Shri Sunil R. Shetty, representing the Trust. Section 153 provides that no notice of any trust shall be entered in the register of members or debenture-holders. Section 187-C stipulates that a person whose name is entered in the register of members of a company as the holder of a share in that company but who does not hold the beneficial interest in such share shall, make a declaration to the company specifying the name and other particulars of the person who holds the beneficial interest in such shares in the manner specified therein.

o The petitioner is a perpetual litigant. This is the third round of litigation on the same subject matter before the CLB. The petitioner started the litigation as early as in 1989, by invoking the jurisdiction of the Karnataka High Court, wherein he challenged the transfer of 85% of shares by the members of his family to the respondents 2 to 5 herein. When the petitioner was unsuccessful, he approached the Supreme Court, but the SLP came to be dismissed. The petitioner thereafter filed C.P. No. 25 of 1999 for almost a similar relief before this Bench, wherein by an order dated 28.02.2002, it was held that no case of oppression or mismanagement was made out and gave an option to the petitioner either continue as a member or exit the Company by transferring his shares at a fair consideration.

The petitioner has challenged the order of the CLB, before the High Court of Karnataka and the appeal is pending.

2. Shri R. Murari, learned Counsel, while opposing the maintainability application submitted:

- o The issue of maintainability raised by the applicants involves determination of factual matters concerning the issue of preference shares and the consequent conversion into equity shares which cannot be gone into in the present proceedings and can only be considered along with other issues during the hearing of the main petition. The Company has issued the preference shares for ulterior purposes. The petitioner was unaware of the conversion of the preference shares into equity shares, which is being challenged before the CLB. After filing of the company petition, the respondents have sought to file certain documents reflecting the present shareholding of the Company in which the petitioner's shareholding is shown as having been reduced to 1.42% of shares of the Company. This reduction is on account of the conversion of the preference shares into equity, by the Company. The application to amend the main petition for setting aside the conversion of the cumulative preference shares into equity shares having been allowed, relates back to the date of the main petition. By virtue of the doctrine of relation back which generally governs, amendment of pleadings, the petition as amended would be deemed to have been filed originally as such and the evidence shall have to be appreciated in the light of the averments made in the amended petition, unless for reasons the court excludes the applicability of the doctrine, as held in *Siddalingamma v. Mamtha Shenoy* issuance and allotment of the preference shares as well as the equity shares and therefore, the applicants cannot seek to rely upon the impugned allotments or conversion or seek to contend on that basis that the petitioner does not have the requisite percentage to maintain the main petition. The issue of further shares which is challenged in the main petition cannot be taken into account in computing the shareholding of the petitioner or be used to determine his eligibility to maintain the company petition. The petitioner originally held 5060 shares constituting 15.60% shares of the Company. The Company had issued in 2006 redeemable cumulative preference shares and such preference shares were later converted into equity shares on 20.09.2006, as a result of which percentage of shareholding of the petitioner has been reduced to 1.42%. In a petition under Sections 397 and 398, when the

shareholding of the petitioners has been reduced below 10 percent on account of the further issue of shares and if the issue of further shares is also challenged in the petition, then the petition will not be dismissed as not maintainable in terms of Section 399 of the Act, instead the allegations relating to the issue of further shares would be examined first as to whether the same is an oppressive act and if it is found to be so then only other allegations in petition would be examined, as held in (a) Mrs. Farhat Sheikh v. Esemem Metalo Chemicals Private Limited and Ors. and Detinners Private Limited and Ors. T.N.K. Govindaraju Chetty and Co.

and Ors. v. Kadri Mills (CBE) Limited and Ors. (1999) Vol. 96 CC 871; (c) Om Prakash Gupta and Ors. v. Hicks Thermometers (India) Ltd. and Anr. S. Ajith Singh and Anr. v. DSS Enterprises Private Limited and Ors. (2002) Vol. 109 CC 597; and (e) Dinesh Sharma and Anr. v. Vardaan Agrotech Private Limited and Ors. (2007) Vol. J35 CC 133. The petitioner's holding of 1.42% of the share capital of the Company has been arrived at only after including the impugned allotments and in the absence of the same, the eligibility of the petitioner to maintain the petition can never be in doubt. The Company offered preference shares to the petitioner to be refused by him so that no one would invest in the Company. As long as the petitioner has not subscribed to the preference shares, he can challenge the impugned allotments.

o The petitioner is not a perpetual litigant and all litigations have been commenced by him in order to protect his interest as a shareholder. The notice of the extra ordinary general meeting dated 06.02.2006 would show that the Company had proposed (i) to increase the authorized capital of Rs. 4 lakhs to Rs. 80 lakhs by creation of 36,000 equity shares of Rs. 100/- and 40,000 cumulative preference shares of Rs. 100/- which are redeemable or convertible or partly redeemable or partly convertible as the board of directors may determine at the time of issue of such shares; and (ii) to develop the property belonging to the Company and build residential apartments to be funded by issue of preference share capital. The offer made to the shareholders is not in tune with the resolution contained in the notice of the extra ordinary-general meeting of September 2006.

o By virtue of the JVA dated 20.06.2006, the Company has to handover its property to the sixth respondent, controlled by the respondents 2 to 5, for development and construction of apartments. The entire cost of development of land and construction will be provided by the sixth respondent. The Company needs no funds for the project. The sixth respondent has to pay to the Company a meagre Sum of Rs. 50/- per sq. feet of the saleable built up area of apartments as and when the same is sold to any buyers. The directors report dated 09.08.2006 for the year ended 31.03.2006 on the contrary states that the Company has issued 27,440 cumulative preference shares of Rs. 100/- at a premium of Rs. 1.37 crores at the insistence of the banks/Institutions. The balance sheet for the year ended 31.03.2006 discloses only unsecured loans of Rs. 3.35 crores representing the lease deposit and there are no loans either secured or unsecured, availed from any Banks or Financial Institutions. There has been no income from the lease deposit and no cash balance is reflected in the accounts maintained by the Company. Hence the statement of the directors in their report is not true. Furthermore, when the funds raised by enhancement of capital came to be utilized for purposes other than for which the capital was raised, it would amount to grave act of oppression in the facts of the case, as held in Goldmark Enterprise Limited v. Pondy Metal and Rolling Mills Private Limited and Ors.

o The auditors' report dated 09.08.2006 speaks of the proposal to issue cumulative preference shares which are convertible into equity shares by the board as it may deem fit, whereas the preference shares have been converted into equity capital within two months without giving any reasons. The Company is aware that the petitioner will not subscribe to the preference shares. The Company is dealing only with the entities of the respondent 2-5 and entered into three agreements in respect of the lands belonging to the Company, thereby appropriating the lands of the Company for themselves and carrying out developmental activities thereon to deprive the petitioner of such benefits.

o The shareholding as on 30.09.2006 furnished by the Company discloses 31304 shares held in the name of R.N. Shetty Family Trust, a new shareholder. The allotment in favour of the Trust having been hit by the provisions of Section 153, is not valid. The provisions of Section 153 are mandatory and continue to be on the

statute and as such required to be followed, as held in Stock Holding Corporation of India Ltd. and Anr. v. Bharat Petroleum Corporation Ltd. (1998) Vol. 91 CC 862. Accordingly, the Company cannot take note of trust and no notice of any trust would be entered in the register of members or debenture holders. Section 3 of the Indian Trusts Act defines a Trust as an obligation annexed to the ownership of property. A Trust is thus not an independent legal entity entitling it to hold property in its name. As at 31.03.2007 the total paid up capital of the Company is of Rs. 32.50 lakhs and 29,000 shares have been allotted in the name of R.N. Shetty Family Trust. If the shares held by R.N. Shetty Family are ignored as not being valid, the petitioner can maintain the petition and as a consequence, if the main petition is found maintainable, notice may be ordered to the proposed parties before hearing the main matter.

3. I have considered the arguments of learned Counsel for the parties.

The short issue before me is whether the petitioner does qualify under Section 399 to invoke the equitable jurisdiction of the Company Law Board under Section 397/398 of the Act for the alleged acts of oppression and mismanagement in the affairs of the Company. Towards this end, it shall be seen whether the petitioner has fulfilled the minimum qualification, which members should possess, either numerical strength or the extent of their share capital as mandated in Section 399. This Section lays down that (a) in the case of a Company having a share capital, members constituting not less than one hundred members of the Company or not less than one-tenth of the total number of its members, whichever is less or members holding not less than one-tenth of the issued share capital of the Company; and (b) in the case of a Company not having a share capital, not less than one-fifth of the total number of its members, shall have the right to apply under Section 397 or Section 398. In the present case, the Company having share capital, members constituting not less than one hundred members of the Company or not less than one-tenth of the total number of its members, whichever is less or members holding not less than one-tenth of the total issued share capital of the Company, shall have the right to apply under Section 397/398. The petitioner herein claims to hold 15.60% of the paid up capital of the Company, apart from 76 shares, being the subject matter of an appeal in MFA No. 3 of 2005 before the

High Court of Karnataka arising out of the CLB order dated 28.02.2002 made in C.P. No. 25/1999. The board of directors of the Company had approved at the meeting held in April 2006 a proposal to issue 32500, 10% redeemable cumulative preference shares (RCPS) of Rs. 100/- each at a premium of Rs. 400/- per RCPS on rights basis to the existing share holders in the ratio of ten RCPS for every one equity share held by the members. Accordingly, the Company had offered 5060 shares to the petitioner as per his entitlement which were not subscribed for his own reasons. The RCPS issued by the Company in favour of the members came to be subsequently converted into equity shares of Rs. 100 with a premium of Rs. 400/- as approved at the extra ordinary general meeting of the members of the Company held in September, 2006. This conversion of RCPS into equity shares of the Company, resulted in reduction of the shares held by the petitioner from 15.60% to 1.42 %. The petitioner while claiming reliefs under Section 397/398, has inter-alia sought for declaration that the issue of 40,000 cumulative preference shares of Rs. 100/- be declared as null and void. The petitioner further by means of an application (C.A. No. 215 of 2006) prayed that the conversion of 32500 RCPS into equity shares be null and void for the reasons elaborated therein, upon which the petitioner was permitted by an order dated 12.01.2007 to amend the company petition in terms of the prayer made in C.A. No. 215 of 2006. The present sequence of events would show that the issue as well as conversion of RCPS into equity shares is under challenge in the main proceedings, pursuant to allowing of the amendment application (CA No. 215 of 2006) and on account of the principles of doctrine of relation back as enunciated in *Siddalingamma v. Mmamtha Shenoy* (Supra), which, ultimately caused reduction in the share holding of the petitioner from 15.60% to 1.42%. The validity of the issue of RCPS and conversion of such RCPS into equity shares involving substantial factual matters cannot be adjudicated as preliminary issue but only while disposing the company petition on merits. If the petitioner succeeds in his charges against the respondents in the matter of the issue conversion of RCPS into equity shares and in the event of any likelihood of setting aside the issue of RCPS or conversion of RCPS into equity shares, the petitioner will continue to hold 15.60% of the paid up capital of the Company, qualifying him to agitate his grievances under Section 307/308. If on the other hand, the issue of RCPS as well as conversion of RCPS

into equity shares is upheld by this Bench, the share holding of the petitioner would get validly reduced to 1.42%, in which case he shall not have any right to maintain the main petition. This Board in (i) *Om Prakash Gupta and Ors. v. Hicks Thermometers (India) Ltd. and Anr.*

(supra) while considering the question of maintainability of a petition under Section 399 held that when further issue of shares is impugned in a petition, and but for the further issue, if the petition would be maintainable then before proceeding with the other allegations, in the petition, the further issue would be first examined to ascertain the maintainability of the petition; (ii) *Dinesh Sharma and Anr. v. Vardaan Agrotech Private Limited and Ors.* (Supra) held that if shareholding of the petitioners is reduced below 10 per cent, on account of further issue of shares and if the issue of further shares is also challenged in the petition, then, the petition will not be dismissed as not maintainable in terms of Section 399. Instead, the allegations relating to the issue of further shares would be examined first as to whether the same is an oppressive act and if it is found to be so, then only other allegations in the petition would be examined; (iii) *S. Ajith Singh and Anr. v. DSS Enterprises Private Limited and Ors.* (supra) held that where the qualification to apply under Section 399 has been affected by further issue of shares or by admission of new members which is also challenged, the CLB, would first adjudicate on these complaints before examining other issues. Further, whether the petition is maintainable in terms of Section 399 or not would depend upon the findings given on the allegations relating to issue of further shares and admission of new members by transfer of shares and further the petition would not be dismissed in limine as sought for by the respondents; (iv) *T.N.K. Govindaraju Chatty and Co. and Ors. v. Kadri Mills (CBE) Limited and Ors.* (supra) held that when the holding of a petitioner is reduced below 10% due to further allotment of shares and such allotment itself is impugned in a petition under Section 397/398, the petition should be held to be maintainable on the strength of his holding before the further allotment of shares and no further allegations in the petition will be gone into till the issue relating to the allotment of shares is decided and the petitioner succeeds in getting his holding restored to the original percentage, qualifying him to apply under Sections 397 and 398 in terms of Section 399; and (v) *Mrs. Farhat Sheikh v. Esemem Metalo Chemicals Private Limited and Ors.*

and Detinners Private Limited and Ors. (supra) held that when a petitioner is disqualified to apply in case of oppression and mismanagement consequent upon issue of additional share and the transfer of certain shares by some of the share holders of which the petitioners are not aware of and challenged before the CLB, it is not justified to disqualify the petitioner under Section 399 of the Act.

4. In view of the above settled proposition of law, enunciated in various decisions, the right of the petitioner herein to apply under Section 397/398 cannot be denied at the threshold, especially when his shareholding came to be reduced below ten percent, on account of the issue and conversion of RCPS into equity shares of the Company, which are being challenged in the present proceedings. The validity or otherwise of issue and conversion of RCPS into equity shares of the Company shall be considered in the light of the rival claims of the parties, to determine the maintainability of the company petition. The notice dated 06.02.2006 convening the extra ordinary general meeting of the members of the Company on 04.03.2006 contains inter-alia the special business for the increase of authorised share capital of Rs. 4 lakhs to Rs. 80 lakhs by creation of 36000 equity shares of Rs. 100/- each amounting to Rs. 36 lakhs and 40,000 cumulative preference shares of Rs. 100/- each amounting to Rs. 40 lakhs. The notice contemplates that the cumulative preference shares may be either redeemable or convertible or partly redeemable and partly convertible as the board of directors may determine at the time of issue of such shares. The special business further envisages the consequent amendment of the capital clause of the memorandum of association of the Company. The explanatory statement under Section 173(2) appended to the notice, containing among other matters, reads thus: "At present the Company does not have any income other than lease rentals. The Board of Directors proposes to develop the existing property jointly with other interested parties to augment some regular source of income which enables the Company to strengthen it's financial position. In the first instance, it is proposed to build residential apartments with an initial investment of about Rs. 300 to Rs. 350 lakhs. To part finance the said project your directors propose to raise funds to the extent of about Rs. 165 lakhs by issue of Preference Share Capital.

The existing authorised share capital of the Company is Rs. 4,00,000/- divided into 4000 shares of Rs. 100/- each. Hence it is also essential that the authorised share capital of the Company is increased, so that further share capital can be raised.

5. The petitioner in response to the notice of extra ordinary general meeting, by his letter dated 04.03.2006 requested the Chairman of the Company, in view of (a) pendency of the appeal proceedings initiated by him before the Karnataka High Court, in relation to the affairs of the Company; (b) proposal to give away prime properties to third parties for development, thereby creating third party rights over the Company's properties; (c) illegal lease of the Company's properties to M/s RNS Motors; M/s RNS Hotels Ltd., sister concerns owned by the Chairman of the Company; (d) illegal removal of the petitioner from the office of director of the Company, not to precipitate the matters till the High Court of Karnataka disposes of the company appeal in MFA No. 3/2005.

The Company by its reply dated 20.03.2006 while clarifying the issues raised by the petitioner, as not having any bearing on the cases pending before any courts, specifically advised him, relevant portion of which, assuming importance runs as under: The Company has proposed to undertake developmental activities to make the Company a viable unit. The financing Banks normally look for stake of Promoters in the share capital of the Company. Hence Board has proposed to issue shares to the existing members on uniform pro-rata basis. In this context it is essential to increase the authorised share capital of the Company, since the existing authorised share capital is a meagre Rs. 4,00,000/- out of which only Rs. 75,000 is left unsubscribed.

While the Company had sent a letter dated 26.04.2006 offering 5060 RCPS to the petitioner, according to his entitlement, to be accepted by 20.05.2006 in terms of the decision of the board of directors of the Company taken on 24.04.2006, the latter by his letter dated 19.05.2006 requested some time to consider the offer made by the Company.

Thereafter, the Company by its letter dated 22.05.2006 extended the time in favour of the petitioner for submitting his application till 20.06.2006. In furtherness of the request letter dated 20.06.2006 of the petitioner, seeking extension of time

by another two weeks on account of his ill health, it is found that the Company on humanitarian grounds granted further extension of time for his acceptance of the offer for preference shares made to him alongwith the remittances of Rs. 25,35,000/- by 05.07.2006. The petitioner however did not choose to accept the offer made to him to subscribe towards the preference shares, inspite of granting the extension of time on more than one occasion as requested by him. There is no material to suggest that the petitioner has raised any protest against the issue of preference shares at the annual general meeting held on 31.08.2006, in pursuance of the notice dated 27.08.2006, received by him on 29.08.2006. The objection now raised by the petitioner by referring to the directors report dated 09.08.2006, that the Company has issued cumulative preference shares at the insistence of the lending Banks/Institutions is contrary to the reasons stated in the explanatory statement appended to the notice of extra ordinary general meeting dated 06.02.2006, to my mind, is nothing but an after thought and devoid of any merits. In this connection, the Company by its letter dated 20.03.2006, stated supra, advised categorically the petitioner that it has proposed to undertake developmental activities to make the Company a viable unit. The financing Banks normally look for stake of promoters in the share capital of the Company. The board, therefore, proposed to issue shares to the existing members on pro-rata basis. There is, therefore, no insistence but only expectation on the part of the Company's Bankers for enhancement of the stake of the promoters in the share capital of the Company. It is on record that the Company has entered into the JVA dated 20.06.2006 with RNS Infrastructure Ltd., a company controlled by the respondents 2 to 5 to develop the land belonging to the Company and construct apartments thereon, on the terms and conditions specified therein. It is evident that the entire cost of land and construction will be borne by the developer. The Company will get from the developer only a fixed consideration of Rs. 50 per sq.ft. of the saleable built up area of the apartments as and when the same is sold to any buyers.

Notwithstanding these consequences flowing from the JVA, the Company is admittedly a loss making Company with accumulated losses of over Rs. 32 crores. It is relevant to point out that the Company has a meagre share capital of Rs. 3.25 lakhs as at 31.03.2006. The iact of the matter in this background is that the

directors in their wisdom have taken the decision to augment additional funds for the Company by issue and conversion of RCPS, of which the petitioner did not chose to contribute, according to his entitlement, for his own personal reasons.

The thin capital base and the vast accumulated losses would justify the decision of the board of directors of the Company for the issue and conversion of RCPS, in favour of the members. The need and necessity for funds having been prima facie found to be for the benefit and in the interest of the Company, the mere irregularities pointed out by the petitioner in such issue and conversion of RCPS will not nullify the transactions impugned by him. In the process, the petitioner cannot raise any grievances on account of reduction of his shareholding from 15.60% to 1.42%, pursuant to the issue and conversion of RCPS, disqualifying him to apply under Section 397/398. However, at the time of arguments, Shri R. Murari, learned Counsel, brought to my notice regarding (a) issuance of 23940 preference shares on 23.05.2006 in the name of R.N. Shetty Family Trust; (b) allotment of further 5060 preference shares on 08.09.2006 in favour of R.N. Shetty Family Trust, and (c) conversion of 2900 preference shares into equity shares of the Company in September 2006 in favour of R.N. Shetty Family Trust. It is the specific assertion of the petitioner that R.N. Shetty Family Trust is holding a total number of 31394 shares in the Company as per the details disclosed in his application namely C.A. No. 220 of 2007 which is pending disposal for want of completion of the pleadings. The petitioner has raised therein substantial question of law on the issue of any trust holding shares of a company. The extract of the minutes of the meeting of the board of directors held on 23.05.2006 and the list of allottees would show that 23940 preference shares have been allotted in favour of R.N. Shetty Family Trust. The Company has stated in its communication dated nil addressed to the Registrar of Companies that the Company has converted the 10 per cent of redeemable cumulative preference shares of Rs. 100/- each into equity shares of Rs. 100/- in terms of the approval of the board of directors at its meeting held on 25.09.2006 and furnished a list of members who held preference shares and whose shares are converted into equity shares, wherein it is found that 2900 preference shares held in the name of R.N. Shetty Family Trust have been converted into 29000 equity shares. The enclosures to Form No. 2 discloses the allotment of 29000 equity shares in the name of R.N. Shetty Family Trust. The

shareholding of the Company as at 30.09.2006 produced by the Company discloses 31304 shares constituting 87.56% in the name of R.N. Shetty Family Trust. The directors report dated 21.08.2007 speaks of the increase in share capital by Rs. 32.50 lakhs as well as the conversion of preference share capital of the Company into equity share capital with the approval of the shareholders during September 2006. The auditors report dated 21.08.2007 specifies that the Company made preferential allotment of shares in favour of R.N. Shetty Family Trust during the year ended 31.03.2007. In this connection, the addendum to auditors report dated 27.09.2007 assuming relevance, reads as follows: In the Audit Report dated 21.08.2007, in paragraph (xviii) the statement made to the effect that "the Company has made Preferential Allotment to R.N. Shetty Family Trust during the year" is an inadvertent error. Hence the said paragraph is replaced with the following paragraph: xviii) During the year under report the Company has issued Preference Share Capital on Rights basis to the members The said Preference Shares have been later on converted into Equity Share Capital. The Company has complied with applicable provisions of law.

6. It is clear from the foregoing paras that the Company has in fact made preferential allotment of shares to R.N. Shetty Family Trust during the year ended 31.03.2007. The report of the auditor is categorical that the preference shares so issued during the year under report, in the name of R.N. Shetty Family Trust, have been later converted into equity share capital and the Company has complied with applicable provisions of law. There has been no information or material placed by the Company how the inadvertent error crept in the matter of preferential allotment to R.N. Shetty Family Trust stands rectified in accordance with law. Shri R. Venkatavaradan, learned Counsel, attempted to explain that 98.5% shares are held by Shri Sunil R. Shetty, representing the Trust, without production of any material in this behalf, while on the other hand the statement of the shareholding of the Company at 30.09.2006 furnished by the Company would indicate that 70% of shares is held by Shri R. Sunil R. Shetty. If RCPS have been issued and later converted into equity shares in the name of R.N. Shetty family Trust, as contended by the petitioner, RCPS so issued and converted in the name of R.N. Shetty Family Trust must necessarily be ignored, to determine the maintainability of the company petition. The petitioner's right to apply under Section 399 squarely

would depend upon the validity of the issue and conversion of RCPS into equity in the name of R.N. Shetty Family Trust, which involve a mixed question of law and fact and cannot be adjudicated at the preliminary stage. The main petition cannot, therefore, be dismissed at the threshold as not maintainable in terms of Section 399. In the circumstances, it is directed that the parties shall complete the pleadings in C.A. No. 220 of 2007 and other connected applications by filing counter on or before 09.04.2008 and rejoinder to be filed by 25.04.2008. The applicant will take notice to the proposed parties in the connected applications, since prima facie I am of the opinion that the proposed parties must be afforded an opportunity of hearing on account of the involvement of their interest in the subject matter of the proceedings. The decisions in Sangramsinh P. Gaekwad v. Shantadevi P. Gaekwad (Supra) and T.N.K.Govindaraju Chetty v. Kadri Mills (CBE) Limited (Supra) would be relevant only when the validity of the further issue of shares is examined in the main proceedings. The parties shall ensure compliance in completing the pleadings, in terms of this order. Ordered accordingly.

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