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Court : Karnataka

Decided On : Mar-21-2012

Judge : A.S. Bopanna, J.

Acts : Companies Act, 1956 - Sections391, 394

Appeal No. : Company Petition No. 91 of 2009

Appellant : S. Krishna Murthy and Others

Respondent : M/S. Hoysala Building Development

Advocate for Def. : A.H. Bhagavan; R.S. Ravi; M. Chidananda; Prabhulinga K. Navadgi, Advs.

Advocate for Pet/Ap. : C.H. Jadhav, Adv.

Judgement :

(Prayer: This petition is filed under Sections 391 to 394 of the Companies Act, 1956, praying to sanction the Scheme of Arrangement as per Annexure-C, so as to be binding on the respondent Company, all its creditors and shareholders and to pass such other and further orders as are just in the facts and circumstances of the case.)

1. This petition under Sections 391 to 394 of the Companies Act, 1956 (hereinafter referred to as ‘the Act’ for short) is filed seeking sanction of the scheme of

arrangement (Annexure-C) in respect of M/s Hoysala Building Development Company (P) Ltd which is in liquidation (hereinafter referred to as the 'Company in liquidation'). The petitioners herein are the creditors of the Company in liquidation.

2. This Court by the order dated 13.06.2002 in Co.P.No.63/1991 at the instance of the creditors ordered the winding up and the Official Liquidator has been appointed in that regard. During the pendency of the further proceedings, the first petitioner herein with one Sri Varaha Venkatesh propounded a scheme of arrangement (Annexure-C) and approached this Court in C.A.No.1074/2008 for a direction to the respondent company to convene the meeting of the share holders as also the secured and unsecured creditors, to appoint a Chariman for the meeting and fix the schedule for the same. This Court by the order dated 03.03.2009 allowed the application and the meeting of the share holders and the unsecured creditors was ordered to be held on 15.04.2009 at 10.30 a.m and 11.30 a.m. respectively. Sri Sanjay Nair, Advocate was named the Chairman. Accordingly, the meeting had been convened. The creditors have consented to the scheme while the share holders have voted against the scheme. Subsequent thereto, the instant petition has been filed. During the pendency of the petition, an amendment has been introduced only to the petition and the propounder of the scheme (Sir Varaha Venkatesh) who was the second petitioner has been deleted and the present petitioners No.2 to 5 have been brought on record.

3. The filing of the petition had been advertised and was also notified to the Regional Director, Ministry of Corporate Affairs, and the Official Liquidator, who have filed their response indicating deficiency in the scheme. The share holders are also represented by their counsel and have opposed the scheme.

4. In the above background, I have heard Sri B. Aswathaiah, learned counsel for the petitioners, Sri Naganand, learned senior counsel appearing for the share holders and Sri K.S. Mahadevan, learned counsel for the Official Liquidator and perused the materials on record.

5. At the outset, the scope and powers of this Court while considering a scheme for revival of the Company in liquidation under Section 391 to 394 of the Act requires to be understood in its correct perspective. It is true that this Court has

allowed the CA No.1074/2008 filed under Section 391 of the Act for the purpose of convening the meetings of the creditors and the share holders. The correctness and validity of the scheme would however not be considered at that stage since the law laid down by the Hon'ble Supreme Court in the case of Rainbow Denim Limited - vs- Rama Petrochemicals Limited [(2003) 116 Company Cases 640] is that the validity of the scheme would be considered by the High Court only after the consideration and approval of the scheme by the shareholders and the creditors. Hence, the validity of the proposed scheme in the background of the events which have unfolded in the instant case requires to be considered by this Court in this petition.

6. The manner in which the instant case has proceeded would throw up several inconsistencies which have to be noticed since the same would be relevant for the purpose of considering whether the scheme is bona fide in relation to the revival of the company and whether the actual propounder of the scheme is entitled to do so keeping in view the provision contained in Section 391 of the Act.

7. The provision contained in Section 391 of the Act would indicate, what is provided for is any compromise or arrangement to be proposed between the company or any creditor or any member of the company. Hence, only such category of persons envisaged therein could file an application seeking approval of the scheme of arrangement. Further, in a company which is in liquidation, the Official Liquidator in his capacity as representing the company in the absence of the Board of Directors is also entitled to propose such scheme of arrangement. Therefore, the first aspect for consideration is whether the scheme in fact or in effect is propounded by the persons who are entitled to do so in law. Secondly, the legal requirement is that even if such a scheme is proposed and is approved by a majority of the shareholders or creditors or their respective classes who may have voted in favour of the scheme by the requisite majority, the Court has to consider the pros and cons of the scheme. This position of law has been elaborately stated by the Hon'ble Supreme Court in the case of Miheer H. Mafatlal -vs- Mafatlal Industries Limited [(1997) 1 SCC 579].

8. In the above backdrop, the facts in the instant case would reveal the Chairman of the Meeting held on 15.04.2009 has reported that the creditors who were present and voted have approved the scheme of arrangement. On the other hand, the two shareholders Sri C.R. Nagaraja Shetty and Smt. Navaneetha Nagaraj Shetty have voted against the scheme. Insofar as the shareholders, it is to be noticed that the paid up share capital of the Company in liquidation is Rs.10,00,000/- and each of the two shareholders hold shares of Rs.5,00,000/- each. Therefore, the vote against the scheme by the shareholders is 100%. The said shareholders have further appeared before this Court and opposed the scheme by referring to the balance sheets and contending that except for paying amounts to the petitioners herein and similarly placed creditors, the scheme does not augur well for the company and the interest of the shareholders of the company has not been kept in view, moreso when one of them is also a creditor. The investment made by the company is the asset created but the same has not been accounted for in the scheme. It is in that context, contended that the said Sri Varaha Venkatesh is the man behind the scheme who has his personal agenda and not the interest of the company.

9. As noticed, the present petition has been amended deleting the name of Sri Varaha Venkatesh wherever it appears and in the said place, the names of respondent Nos.2 to 5 has been incorporated. The order dated 27.10.2010 passed by the Court in CA No.660/2010 in the instant petition permitting the said amendment would disclose that this Court had taken note of the fact that the original petitioner No.2 (Sri Varaha Venkatesh) is neither a shareholder nor creditor nor worker of the company but had come forward to extend financial support to the first petitioner for implementation of the scheme of arrangement. The applicants in the said application i.e., petitioner Nos.2 to 5 herein have proposed to come on record in place of the second petitioner and in that context, the application was allowed. This aspect of the matter is also relevant.

10. Technically, the petitioners herein who are seeking sanction of the scheme being the creditors no doubt constitute one of the categories contemplated in Section 391 of the Act. However, to understand the very scheme itself and to decide the acceptability, the manner in which it has been proposed and the part to

be performed by the propounder in reviving the company requires to be noticed. The basis on which the propounders of the scheme had approached this Court in C.A.No.1074/2008 seeking convening of the meeting of creditors and shareholders is also relevant since the instant petition cannot be considered divorced from the pleading put forth therein. The second applicant therein (Sri Varaha Venkatesh) had stated about his credit worthiness and being basically into diversified business and about being exposed to various industrial, commercial and business activities in order to contend about his ability to revive the Company in liquidation. It was further averred that he has therefore approached and initiated the scheme for One Time Settlement with the creditors who are the persons who had paid for flats which had not been allotted by the Company in liquidation. The first applicant therein is stated to have agreed for the proposal and as such has consented to the scheme. In that regard, Sri Varaha Venkatesh had agreed to bring in Rs.1,53,00,000/- in stages. Since majority of the investors/allottees/creditors have expressed their willingness for One Time Settlement at 1.5 times their dues, the second applicant (Sri Varaha Venkatesh) is interested in revival of the company and proposed scheme or arrangement. The said averments without any doubt would indicate that Sri Varaha Venkatesh is the propounder of the scheme and the first applicant has only consented to the same and has no role to play in the process of revival.

11. In that backdrop, a perusal of the scheme of arrangement (Annexure-C) which is very brief would indicate that the said pleading is also reflected in the scheme so as to state that Sri Varaha Venkatesh is the main propounder though the name of Sri S. Krishnamurthy i.e., the first applicant representing the investors in the flats is also shown in tabular representation. The fact that the said Sri Varaha Venkatesh who is the propounder of the scheme does not belong to any one of the categories contemplated in Section 391 of the Act in relation to the company is evident inasmuch as the petitioners themselves have subsequently deleted his name from the instant petition. However, no change has been made in the scheme and the fact that he is the person who would be bringing in the money remains un-altered though presently petitioner Nos.2 to 5 have been impleaded to the petition. In fact, the response filed on behalf of the Regional Director has also raised the said question of a person other than the one contemplated under Section 391 of the

Act having propounded the scheme as the same is not permissible in law. It is no doubt true that the money to be brought in by such person would be beneficial to a class of creditors inasmuch as they would receive the amount due from the company but the question is whether such scheme is in compliance of law and whether this Court can grant its seal of approval unmindful of the interest of the company or the shareholders and above all, if it is contrary to public policy.

12. In fact, a similar scheme had arisen for consideration before this Court in the case of Sri Kashinath Dikshit and another - vs- M/s Surgicals and Pharmaceuticals Company (Mysore) Limited (2003 AIR Kant.HCR (NOC) 55), except that the first petitioner therein was a shareholder. In the said case, the relevant contention (which is similar to the instant case) while opposing the scheme was as hereunder:

“10. The official liquidator attached to this Court has filed his objections opposing the scheme of arrangement propounded by the petitioners. Apart from others, the primary objection of the official liquidator seems to be that though the first petitioner is a member of the company in liquidation is not the propounder of the scheme and the second petitioner, who seems to be the propounder of the scheme is neither the shareholder nor the creditor of the company in liquidation and therefore the request made in the petition for approval of the scheme of arrangement is not maintainable under Section 391 of the Act, since under that provision, an application/petition can be filed for sanction of the scheme of arrangement either by a creditor or a member of the company in liquidation or by the official liquidator. The second objection seems to be that the first petitioner has not demonstrated before this Court that on his own how he would revive the company in liquidation and therefore, the arrangement is not a real arrangement for revival of the company in liquidation and it only a ruse to sell the assets of the company to the second petitioner for a price. Therefore, requests this Court not to grant the relief claimed in the petition.”

13. The Court on taking note of the above contention in the background of the law, with reference to the scheme has answered as hereunder:

“17. Petitioners have produced a copy of the scheme of arrangement, which they want it to be sanctioned by this Court. In that, it is stated that one of the shareholders of the company as on the date of winding up order, namely, one Sri Kashinath Dikshit has identified Sri N.J. Patel with a view to revive the company, and the said person is willing to settle the claims of the creditors of the company with a view to revive the company provide the entire share capital of the company is transferred to him and to his nominees in consideration of his settling the claims of the creditors of the company.

18. One of the shareholders of the company in liquidation is the first petitioner in this company petition. He has identified the second petitioner to revive the company in liquidation. This clearly shows that he is not the propounder of the scheme of arrangement for revival of the company. The second petitioner is neither a member nor a creditor of the company. He is willing to settle the claims of the creditors of the company with a view to revive the company in liquidation, provided the entire share capital of the company is transferred in his favour and his nominees. In order to attract Section 391 of the Act, it is necessary that a compromise or arrangement between a company and its creditors or any class of them, or between the company or its members or class of them should propose a compromise or arrangement. When such a scheme is proposed, and the sanction is requested, the Court will have to be satisfied as to the prima facie, that the scheme of arrangement is genuine, bona fide and would be in the interest of the company and its creditors and the application is filed by a person, who is authorised under the provisions of Section 391 of the Act. The Apex Court in the case of S.K. GUPTA vs. K.P. JAIN reported in [1979] 49 Comp. Cas. 342, while considering the scope of Section 391(1) of the Act and who can move the application under that section was pleased to observe:

“Section 391 enables a member or a creditor of the company or a company which is being would up, its liquidator, to make an application to the court proposing a compromise or arrangement between the company and its creditors or any class of them or between the company and its members or any class of them and seeking directions of the Court to convene a meeting of each class of creditors and/or each class of members to whom the compromise or arrangement is

offered. On the Court's giving the directions, the meeting would be convened in which the proposed scheme of compromise and/or arrangement would be submitted for consideration and each class will have to vote upon it and if the scheme is accepted by a majority in number representing three-fourths in value of the creditors or members or class of members, as the case may be, present and voting either in person or where proxy is allowed, by proxy, such approved scheme has to be placed before the Court for sanction of the Court as envisaged in Section 391(2)."

19. The Court was further pleased to observe:

"Section 391(1) itself by a specific and positive provision prescribes, who can move an application under it. Only the creditor or member of that company or a liquidator in the case of company being wound up is entitled to move an application proposing compromise or arrangement. By necessary implication any one other than those specified in the section would not be entitled to move such an application."

20. The second petitioner, who is the propounder for the sanction of scheme of arrangement is neither a member nor a creditor of the company. He has no interest in the affairs of the company. He has only come forward to purchase the assets and liabilities of the company in liquidation by filing an application styled one under Section 391 of the Act. The first petitioner though a member of the company in liquidation, is not the propounder under the scheme. He is only an intermediary in assisting the second petitioner to purchase the assets of the company in liquidation. Therefore, in my opinion, the petition filed for sanction of scheme of arrangement is not maintainable under Section 391 of the Act."

14. The above decision, in my opinion, applies on all fours to the case on hand. Therefore, on that score itself, the instant petition would not be maintainable. However, since the petitioners have subsequently amended this petition and since the counsel for the petitioners has contended that this Court could exercise its power for the proper implementation of the scheme, the matter is examined further.

15. Firstly, the question of this Court stepping in for the proper implementation of the scheme by modifying the same would arise only in a case where the scheme is sanctioned, but it encounters certain difficulty in its implementation. This Court is not enjoined with the obligation of propounding a scheme nor will the Court assume the role of an Appellate Authority to modify the scheme except to examine the validity. In order to examine whether the deletion of Sri Varaha Venkatesh and the impleadment of the petitioner Nos.2 to 5 has made any difference to the scheme as propounded, a perusal of the petition would demonstrate that except the amendment to the cause-title and incorporating the words 'petitioner Nos.2 to 5' wherever the word 'second petitioner' existed, there is no indication as to the manner in which the present petitioners have propounded the scheme. The petition indicates that in para 14, the earlier resolution passed in the meeting of the creditors had been extracted. In the extracted portion, the resolution of the meeting of the creditors was to authorise Sri S. Krishnamurthy and Sri Varaha Venkatesh. Strangely, the resolution passed elsewhere, but only extracted in the petition has also been amended in the petition by deleting the name of Sri Varaha Venkatesh and the names of petitioner Nos.2 to 5 have been incorporated therein though the fact is that no such resolution was passed.

16. Be that as it may, the scheme with reference to the second applicant therein and the pleadings in C.A.No.1074/2008 makes it clear that the funds were to be provided by Sri Varaha Venkatesh and his business acumen had been stated to indicate that he has the capacity to revive the company. But, on having impleaded the petitioner Nos.2 to 5 to this petition, there is no indication whatsoever about the manner in which the funds are to be arranged by the petitioners herein amongst themselves or about their competence in reviving a building development company. It is no doubt true that during the course of the proceedings, in order to establish their bonafides to organise the funds, a sum of Rs.1,80,00,000/- (Rupees One crore eight lakhs only) has been deposited before the Official Liquidator as permitted by this Court. It would be rather difficult for this Court to accept that it is the funds belonging to the petitioners themselves keeping in perspective the manner in which the scheme has been propounded.

17. As noticed, the petitioners herein are themselves the creditors who have agreed to receive 1.5 times of their dues as One Time Settlement by way of refund of the amount which was subscribed by them for allotment of flats to be built by the company. It would be abnormal to accept that they themselves would invest the money to revive the company so as to clear their own dues and that of the others and that too by refunding more than what was paid by them. Further, on the deposited amount being disbursed, there is no other indication as to how the company would be revived and the manner in which the activities of the company would be carried on by the petitioners. That apart, the scheme propounded indicates that the entire share capital of the company held by the shareholders of the company would stand transferred and vested with the second applicant or his nominees, the reference therein being to Sri Varaha Venkatesh. On the petitioners having come on record, that aspect of the matter in the scheme does not see any change. The petitioners therefore are name lenders to the propounder who is behind the veil for mutual benefit and the interest of the company is not protected.

18. In the instant case, though it is contended that the company does not possess any assets, there are other aspects relating to the property wherein the project of the Company in liquidation was being implemented. The company had undertaken to construct the apartment in Sy.No.79/4, III Block, Jayanagar, Bangalore by entering into an agreement to purchase the land from one Sri Shankar Reddy under the agreement dated 26.01.1981. However, the construction is stated to have been put up in Sy.No.79/5B regarding which a claim is raised by Sri Narayan and others. Undisputedly, that has resulted in civil litigation and the matter is presently stated to be pending before the Hon’ble Supreme Court. The ultimate result in the litigation or any understanding with actual owner would decide the fortunes of the Company in liquidation. Hence, the revival of the company is also mired in uncertainties and the pointer therefore is to the speculative business interest of the original propounder which becomes relevant. Even in respect of the half constructed building belonging to the company, the order sheet dated 28.05.2010 in this proceedings indicates that the valuer appointed by this Court has valued it at Rs.21,86,00,000/- and on 04.06.2010, the counsel for Official Liquidator has submitted the said value represents only that of the building and not land.

19. All the above aspects and the perusal of the scheme (Annexure-C) would indicate that the petitioners herein are not the actual propounders of the scheme so as to revive the company for the benefit of the company or its members. The petitioners being few among the investors for purchase of flats, thereby having become the creditors as they have not been allotted the flats have lent their names to a propounder who does not qualify under Section 391 of the Act. The camouflage is because their interest of receiving the money is protected. Though one can sympathise to the plight of the petitioners and similarly placed persons and could have appreciated the fact that they would receive their money, the benefit that would be derived in the process by a person who is not connected with the company does not have the sanction of law. The Act enjoins an onerous duty on this Court while choosing the option of revival of the company as against its winding up. Such responsibility has to be discharged keeping in view the interest of the company for its revival. Mere settling the outstandings of certain class of persons to the detriment of the company or its members is not the object. In any event, the recovery and disbursement would be done in the process of winding up.

20. The prayer made by the petitioners is therefore liable to be rejected, which is accordingly done. They would be entitled to seek refund of the amount deposited with the Official Liquidator, who shall pay the same under acknowledgment.

In the result, the petition is dismissed. No order as to costs.

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