(1999) 09 KL CK 0050

High Court Of Kerala

Case No: M.C.A. No. 6 of 1999 and C.P. No. 18 of 1999

St. Mary''s Finance Ltd.	APPELLANT
Vs	
R.G. Jayaprakash and Others	RESPONDENT

Date of Decision: Sept. 28, 1999

Acts Referred:

- Companies Act, 1956 - Section 391, 393, 393(1), 394, 433

Citation: (2000) 99 CompCas 359

Hon'ble Judges: K.A. Abdul Gafoor, J

Bench: Single Bench

Advocate: Gem Paul Edampadam, in C.A. No. 95 of 1999, E.M. Joseph, in C.A. No. 91 of 1999, Jacob Mathew Manalil, in C.A. Nos. 78, 113, 172, 175, 298, 299 and 309 of 1999, N.N. Venkitachalam, in C.A. No. 81 of 1999, Abraham John, in C.A. No. 64 of 1999 and T.N. Hareendran, in C.A. No. 320 of 1999, for the Appellant; K. Surendra Mohan, for respondent No. 1, Ranjith Thampan, for respondents Nos. 2 to 6, M.P. Ashok Kumar, for respondent No. 7, Ursula Francis, for respondents Nos. 8 and 9, K.D. Mahadevan and Ramesh Chander for respondents Nos. 10 and 11, for the Respondent

Judgement

K.A. Abdul Gafoor, J.

M.C.A. No. 6 of 1999 is filed by a company named St. Mary''s Finance Limited, Nedumchalil Buildings, Mullassery Canal Road, Cochin-682011, u/s 391(1) of the Companies Act, 1956 ("the Act"). The said company will be referred to as the company hereinafter. The company prayed that a meeting of the creditors be held "for the purpose of considering and if thought fit, approving, with or without modification a scheme of compromise or arrangement proposed to be made between the company and the said creditors". The proposed scheme is produced as annexure "F". The application was filed on January 20, 1999. On January 21, 1999, when it came up for admission, this court passed an order appointing a chairman for the conduct of the said meeting to be held on March 7, 1999. In the said application it is admitted by the company that it had been declared a "Nidhi"

company as per notification dated December 17, 1988, by the Central Government. Nidhi company is referred to in Section 620A of the said Act to mean a mutual benefit society. It is averred in the application that the main objects of the company are as follows.

"(1) To encourage the habit of thrift and savings among the members of the company.

(2) To lend or advance monies only to the members of the company with or without security and to provide for the repayment of the same.

(3) To receive deposits, savings, fixed and recurring, exclusively from the members of the company. The company, however, shall not do the business of banking within the meaning of the provision of the Banking Regulation Act, 1949, and also chit fund business".

2. It is also admitted that the first three promoters of the company whose names are included in annexure C had caused to incorporate another company called St. Mary''s Properties Ltd. The first three persons, mentioned are : (1) Mr. Boby Varghese, (2) Mr. M.U. Varkey (now deceased) and (3) Smt. Susy Boby Varghese. The remaining two are now two among the three directors of the company, the remaining being one Mr. M.V. Thampi. Thus, it is clear that the directors of the company are also the directors of St. Mary''s Properties Ltd, and that they are by reason of that intimately interested in the affairs of St. Mary''s Properties Ltd. That is evident from the averments in paragraph 7 of the application. It is also evident from the averments in paragraph 8 of the application that :

"The immediate source of finance available was from its sister concern, viz., St. Mary''s Finance Ltd. Thus St. Mary''s Properties Ltd., availed of finance from St. Mary''s Finance Ltd. The total finance advanced by St. Mary''s Finance Ltd., to St. Mary''s Properties Ltd. is Rs. 7,67,37,784 (rupees seven crores sixty-seven lakhs thirty-seven thousand and seven hundred and eighty-four only)".

3. Thus, it is an admitted position that the company had advanced a huge amount from the company to its admittedly sister concern called St. Mary''s Properties Ltd., its directors are none other than two of the directors of the company and as admitted in paragraph 7 "along with their other family members". Thus, the directors of the company had advanced heavily to their sister concern in which the directors of the company are directly and intimately interested. Because, according to them, as averred in paragraph 8 of the application, "the immediate source of finance was available from its sister concern viz., St. Mary''s Finance Ltd." This was as if money in one pocket is being transferred to another pocket in the same coat. Paragraph 9 of the application discloses that the company had assets of Rs. 18,40,41,319 as on December 31, 1998, which included "loans and advances considered good" Rs. 10,36,41,412. It also discloses that there is another loan to St. Mary''s Properties Ltd., to the tune of Rs. 7,67,37,784. This is separately shown in

paragraph 9 as independent of the "loans and advances considered good" to mean, even according to the company, that the loans to St. Mary''s Properties Ltd., are not considered good by the company itself. In paragraph 10 of the application the company averred that there is a surplus asset of Rs. 1,15,45,482 (rupees one crore fifteen lakhs forty-five thousand four hundred and eighty-two only). Thus, this rupees one and odd crore surplus is taking into account the said Rs. 7.67 crores advanced to St. Mary''s Properties Ltd., as asset. It is further stated in paragraph 11 that :

"the overall recession prevalent today has created a situation by which the company has to face a liquidity crisis which resulted in its inability to meet its commitments and obligations on demand",

4. This is an admitted financial bankruptcy that it is unable to meet its commitments and obligations. It is further averred that :

"as is usual in such situations the debtors of the company also stopped their payments and a large number of the company''s creditors began withdrawing deposits".

5. As per the main objects, the only purpose for which the company is constituted is to lend advance and to receive deposits. In such circumstances, there will be withdrawal and remittances on everyday as it is its business. It is because of the inability to meet its commitments and obligations on demand, the company is proposing a scheme to pay off its liability of Rs. 17,24,95,837, towards its depositors in instalments, 10 per cent. by December 31, 2000, 20 per cent. each by December 31, 2001, December 31, 2002, and December 31, 2003, and balance 30 per cent, by December 31, 2004. That means the deposits collected by the company from its members and creditors will be disbursed to them piecemeal as mentioned above. The deposits had been collected admittedly promising a heavy rate of interest, 18 to 20 per cent. The scheme provides that by March 31, 2000, only 10 per cent. of the deposits will be paid, that means it will be far less than accrued interest till that date. Regarding payment of interest nothing is mentioned in the scheme. More interesting is how this amount would be paid and what were the sources at the respective point of time is also not disclosed. Even according to the company as averred in paragraph 11 "the debtor of the company also stopped their payments". In such circumstances, it was incumbent to indicate in the scheme how the company would be paying the amounts in terms of the scheme. There is also no averment in the application that the scheme had been approved by the board of directors of the company.

6. Immediately after the order dated January 21, 1999, to convene the meeting, a few of the creditors and their association approached this court seeking modification of the said order, in C.A. Nos. 78 of 1999, 81 of 1999, 91 of 1999 and 95 of 1999.

7. In C.A. No. 78 of 1999 the applicants had asked for an order to cancel or postpone the creditors meeting and a further order directing the directors of the company to desist from collecting blank proxy forms signed by the creditors. It has been averred that all the creditors had not been sent notices with necessary statutory requirements and enclosures ; that the managing director, one Mr. Boby Varghese, of the company had written to each of the creditors a letter, produced as annexure "1", wherein he had mentioned that the company is facing a hard and difficult situation. It is averred in the application that the attempt of the company is to delay and defeat the creditors and their just and legitimate dues and notices are not properly sent with necessary enclosures thereto such as the proposed scheme and statement in respect of the same. It is also contended that notice contained a statement that "no director in his capacity as a member of the company has any personal interest in the compromise agreement placed before the creditors". It is submitted that this statement was misleading and untrue as, even as mentioned in the M.C.A. itself, the two directors including Sri Boby Varghese and his wife had interests in St. Mary''s Properties Ltd., to which a large amount of Rs. 7.6 crores, as admitted in M.C.A. No. 6 of 1999 itself, had been sanctioned. Therefore, the directors of the company as members of the company were really interested in the compromise. Therefore, such statement in the notice is incorrect and creditors were kept in the dark as to the real situation. It is the right of every member and creditor to know about the interest of the directors, if any, and that right had been denied to the creditors. Therefore, the meeting itself is convened in an illegal manner.

8. In C.A. No. 81 of 1999, the applicant prayed for an order rejecting the M. C. A There also it is averred that he is a depositor and the attempt of the company is to delay and defeat the creditors. It is submitted that the major chunk of the deposits received by the company had been given by way of unsecured loan to St. Mary''s Properties Ltd., which is managed by the same managing director and two other directors of the company. In the counter-affidavit, the company had admitted that "the company transacts business only with its members as envisaged in the objects Clauses 2 and 3 of the memorandum of association of the company". It is contended that St. Mary''s Properties Ltd., is not a member.

9. C.A No. 91 of 1999 is filed by seven depositors who have made deposits on promise of 18 to 20 per cent. interest per annum on their deposit amounts. According to them Sri Boby Varghese, who has filed the M.C.A and obtained the order for convening the meeting of the creditors, had issued a letter dated February 22, 1999, to the creditors asking every creditor that the proxy form sent from the court shall be signed and sent to him. He cautions the depositors in that notice that... (If the resolution is defeated there are all chances for the company being liquidated). He further adds that in such case his promise cannot be carried out, so the proxy form should be signed and brought to him in advance so as to ensure success of the resolution. He also makes it clear that in spite of such submission of proxy, each of them should be present in the meeting as well to express their

opinion. It is pointed out that this is an undue influence on the creditors to seek their proxy in favour of the resolution in which the company''s directors are deeply interested.

10. C.A. No. 95 of 1999 is filed by another creditor seeking a direction to postpone the meeting. The averments are almost on the same lines as in the other company applications. It is also averred that the company had not so far disclosed the list of the creditors and was withholding such information.

11. This court considered C.A. Nos. 81 of 1999 and 91 of 1999 and passed a detailed order dated March 2, 1999. This court reminded itself that :

"This court cannot forget the fact that what is involved here is the hard earned money of a number of depositors who had deposited their life savings in this company."

12. This court also took note that ;

"As the matter had reached this court the endeavour of the court should be to protect, as far as possible, the interests of the depositors in the company."

13. Therefore, this court did feel that a mechanical rejection of the application at that stage on the ground that there was no full and frank disclosure of some of the matters by the company or that the applicant had ulterior motive to prosper himself at the expense of the company would only bring untold misery and suffering to the depositors in the company. So the prayer to postpone the meeting to be held on March 7, 1999, was not conceded at that stage. Their right to object was preserved for being considered, when this court takes up the question of approving the arrangement, as was done in In Re: Bengal National Textile Mills Ltd., Accordingly orders were passed as follows :

"Thus reserving the right in the creditors and the applicants herein to put forward all their objections at the stage of considering whether the scheme or arrangement ought or ought not to be accepted or should be accepted with or without modification, the prayer to recall the ex parte order made by this court on January 21, 1999, and/or to stay the holding of the meeting of the creditors stated to be held on March 7, 1999, is rejected".

14. In the light of this order I am bound to consider their contentions again, taking into consideration the petition filed under Rule 79 of the Companies (Court) Rules, a petition to confirm the compromise. Such a petition is now filed with necessary corrections and incorporations as C.A. No. 126 of 1999.

15. At the same time C.P. No. 18 of 1999 is also filed on April 6, 1999, seeking an order of winding up of the company or such other order as may be made in that compromise. A copy of the M. C. A. is an annexure to the company petition. In such circumstances, I thought that it is fit to direct the petitioner to give notice to counsel

for the company. Accordingly notice was so given to the company and the company has filed a counter-affidavit in this company petition.

16. In the meanwhile the meeting as directed in the order dated January 21, 1999, in M.C.A. No. 6 of 1999 was conducted on March 7, 1999, and the chairman appointed by this court has filed his report. It is stated in the report that notices were sent to 1863 creditors. But only 893 were present in the meeting. When the voting was taken up 427 present alone voted. Shri Boby Varghese, who has filed the M.C.A. No. 6 of 1999 in his capacity as director, had voted for 1033 proxy holders. The result of the votes including by proxies through the applicant in M. C. A. No. 6 of 1999, shows that there was majority support to the resolution. But it has to be taken note of that out of 1883 creditors to whom notices were sent only 893 persons participated in the meeting and out of 893, more than 50 per cent. viz., 465 persons did not cast their vote, added to this about 1033 proxies in the pocket of the director himself. It is in this background that annexure A1 to C. A. No. 91 of 1999 wherein Mr. Boby Varghese had cautioned each of the creditors that in case the resolution is voted out, he could not be in a position to honour his promise and the company may go into liquidation has to be viewed. In this background, the allegation of undue influence exerted by Sri Boby Varghese has to be considered.

17. It is contended by the creditors who opposed the arrangement that the meeting itself was illegal as--(1) no notice was given to all the creditors ; (2) there was untrue statement in the notice that the directors were not interested in the compromise ; (3) the necessary statement and copy of the compromise were not made known to the participants as enclosures to the meeting and (4) there was undue influence on the part of Sri Boby Varghese by issuing communications as mentioned above to each of the creditors to force them to give proxy in favour of the resolution, as evident from his own voting for 1033 persons. It is admitted before me that Sri Boby Varghese himself is not a creditor entitled to be present in the meeting of creditors, he participated as proxy holder of 1033 creditors.

18. I have to examine whether notice was given to all the creditors. The company does not dispute that all the creditors of the company as on the date of the meeting are entitled to notice. The order of this court does not limit issuance of notice to the creditors with reference to any cut off date including December 31, 1998, or the date of order. Necessarily as per the spirit of the order, all the creditors as on the date of the said order at least have to be informed. A few of the applicants before me or those who have deposited money in the company have not been invited to the meeting. It is complained by the applicant in C. A. No. 81 of 1999 that though he is a depositor and admitted to be a member in the counter-affidavit of the company, he has not been served with notice. It is submitted that the first applicant did not receive any notice, but that is not averred in the petition. In C.A. No. 95 of 1999 it is submitted that though the applicant has received intimation, the other members of the family, who have also deposits in the company did not receive any notice. The

applicant has also filed an objection to the chairman''s report enclosing therewith the deposit receipts. When the chairman appointed by this court has reported that he had issued notice on the basis of the list submitted by the company, there is no reason to disbelieve that. He has also issued notification in the newspapers with regard to the convening of the meeting. In such circumstances that objection cannot be accepted.

19. It is submitted further that, as mentioned above, the directors did not disclose their interest in the scheme of arrangement or compromise as proposed. It is contended that the notice contained a specific recital that the directors as the members of the company did not have any interest in the compromise proposed. This aspect is highlighted by the applicant in C.A. Nos. 172 of 1999 and 175 of 1999. The largest debtor of the company is St. Mary''s Properties Ltd. As admitted in paragraph 9 of the M.C.A. No. 6 of 1999, the said company owes an amount of Rs. 7,67,37,784 as on December 31, 1998. Admittedly Boby Varghese, who had filed affidavit in support of M.C.A. No. 6 of 1999, the director of the company, is the managing director of St. Mary''s Properties Ltd. It is an admitted position as averred by himself in paragraph 7 of M.C.A. that he had sponsored St. Mary''s Properties Ltd., and in paragraph 8 that the immediate source of finance for that new company was from the company, which he describes as a sister concern. As per the averments in paragraph 9, the company does not categorise this huge loan given to St. Mary''s Properties among "loans and advances considered good". The company had come to a situation of inability to meet its commitments and obligations only because of the diversion of this huge amount to M/s. St. Mary''s Properties Ltd., in which at least two out of the three directors of the company are interested. I had asked counsel for the company to submit in the form of a statement with dates of the amounts paid to St. Mary''s Properties Ltd. along with a memo dated September 28, 1999, a statement of accounts consisting of four pages detailing the amounts paid to the said company is furnished to me. That commences from July 4, 1998, to January 21, 1999, the date of filing the M.C.A. No. 6 of 1999 for convening the meeting of the creditors to approve the compromise or arrangement. The statement shows that the transaction is with one Mr. M.C. Jacob. When asked with particular reference to Sri M.C. Jacob, counsel, in consultation with the officers of the company available in the court, submits that the amount mentioned in the statement is the amount due from St. Mary''s Properties Ltd. It is only because of this diversion of the fund to the tune of Rs. 7.67 crores during July 4, 1998 to January 20, 1999, that the company placed itself into the present predicament. If such diversion had not taken place, necessarily the company would not have faced this situation. This diversion of the fund as averred in paragraph 8 of the M. C. A., itself, is "as the immediate source of finance available for St. Mary''s Properties Ltd., was from St. Mary''s Finance Ltd." The arrangement now proposed in the M. C. A. to pay off the depositors their deposits in instalments of 10 per cent. by March 31, 2000, 20 per cent. each by March 31, 2001, March 31, 2002, and March 31, 2003, and the rest

by March 31, 2004, is because of the company''s inability to obtain the amounts advanced to the sister concern in which the directors are also interested. This arrangement is necessary to keep the company breathing if not functioning, to pay them off, with the interest that they can collect from the amounts advanced to others, which they have categorised as loans and advances considered good, to the tune of Rs. 10,36,41,412 which carry admittedly more than 20 per cent. interest. It is contended that the interest so collected will be sufficient to meet the instalment payments to depositors towards their capital investments and this will save the directors from their inability and that they can safeguard their interest in St. Mary''s Properties Ltd., as interest will not be paid to depositors as per the scheme. When it is an admitted position before me that St. Mary''s Properties was sponsored and promoted by Mr. Boby Varghese who has filed affidavit in support of the application presented by the company and as himself is a director of the St. Mary''s Properties, necessarily the company was bound to inform the creditors about his interest. Thus, the valid information which is very vital to the scheme was withheld from the creditors. Thus the company had violated Section 393(1)(a) of the Act. It is held in In Re: Sidhpur Mills Co. Ltd., , 314, as follows :

"Moreover, the expression ''whether in their capacity as such or as members or creditors of the company or otherwise'' does not fit in with the contention of the learned Solicitor General. That expression makes it clear that the interests which are particularly to be mentioned by the concerned persons are not interests which they hold or possess as such concerned persons in the company, but also ''or otherwise''. This is a clear indication of the mind of the Legislature that the interests which a director etc., has to mention in the statement is not only the interests which he holds or possesses as such director, but all the interests which he holds or possesses in any other capacity. In my judgment the section is cast in the widest possible terms. It states in express terms that the interests which the director possesses not only as a member or a creditor but any other interests which he possesses in any other capacity have got to be mentioned in the statement under Clause (a). In other words, if the director possesses any interest of whatever kind in the scheme, then, that interest must be stated in the statement accompanying the scheme."

20. In Navjivan Mills Co. Ltd., In re [1972] 42 Comp Cas 265 the Gujarat High Court again held as follows (page 308) :

"Section 393 is mandatory in terms. Before the court can proceed to apply its mind to a scheme of compromise and arrangement it must be satisfied that annexed to the notice convening the meeting there is a statement drawn up in conformity with the requirements of Section 393(1)(a), (vide In Re: Sidhpur Mills Co. Ltd., ."

21. Thus, when a scheme of compromise is presented, and notice of meeting for consideration of such scheme is sent to the creditors of the company, there shall be full and fair disclosure of the interest of the directors as members of the company, is

a prerequisite and a statutory essentiality in terms of Section 393(1)(a). In this case, the interest of Mr. Boby Varghese and another director, in St. Mary''s Properties Ltd., the largest debtor of the companyis not disclosed. Because of the compromise, the real beneficiary is St. Mary''s Properties Ltd., to whom the company had heavily advanced. I cannot find fault with the chairman who had convened the meeting and sent notices, because he was never informed by the company of the interest of the directors. Therefore, the company not only withheld that valid information from the creditors alone ; but also from the chairman as well. So the meeting, whatever be the majority in support of the scheme the company managed to obtain through compelled proxies, has no validity in the eye of law. On that sole reason itself, the compromise now suggested or as modified cannot be accepted.

22. This is not the only reason for the rejection of the scheme. There are plenty of others. It is admitted that the company is a Nidhi company. It is admitted that the Nidhi company had certain restrictions as imposed by the Government of India and the Reserve Bank of India and also by the memorandum of association upon which the company itself is constituted. The company is conscious when it is averred in paragraph 2 of the affidavit filed in support of M. C. A. No. 6 of 1999 that its object is "to lend or advance monies only to the members of the company" and "to receive deposits, savings, fixed and recurring, exclusively from the members of the company". It is admitted before me that St. Mary''s Properties Ltd. is not a member of the company. It is admitted as is averred in paragraph 8 of the affidavit in M. C. A. No. 6 of 1999 that "the total finance advanced by St. Mary''s Finance Ltd., to St. Mary''s Properties Ltd., is Rs. 7,67,37,784". Thus, the amount advanced to St. Mary''s Properties is a fact admitted in writing. Thus, the company had acted contrary to its object itself by advancing amount to another company, that too to a large and huge extent. A finance company shall always be strict in its dealings and shall be confined to the restrictions imposed by the authorities and by its memorandum of association. The loan given to another corporate body in which the directors are interested, contrary to the restrictions imposed by the Reserve Bank of India, by the Central Government and the memorandum of association, itself can be said to be in simple words "total mismanagement" if not "gross financial impropriety" because diversion of fund is as if currency is changed from one pocket to another of the same coat. When there is mismanagement by the managers including by the one who had filed the affidavit styling himself as a director, who withheld vital information from the creditors and also to the chairman about their interest in the compromise or arrangement, necessarily a scheme proposed by them cannot be allowed to work out as it will not be to the benefit of the depositors. As mentioned by this court in the order dated. March 2, 1999, it is their hard earned money and what the company proposes to pay is in instalments without even a whisper regarding interest.

23. In this background, it has to be noted that a Nidhi company cannot lend any amount in excess of 7.5 lakhs as contained in the statutory Notification No. G.S.R.

603(E), dated October 20, 1997, of the Government of India. Clause a (ii) thereof provides that "no company declared as Nidhi shall give to any borrower loans or advances exceeding Rs. 7.5 lakhs or 1 per cent. of the total deposits of the company whichever is less". Here the company had given a loan to another corporate body to the tune of Rs. 7.67 crores. That is also a violation of the statutory restrictions imposed on the company. Such statutory restrictions are imposed to protect the interest of the depositors as the company--men shall not put all the eggs into one basket to spoil it in one moment. The applications submitted by several depositors and also the letters written by several to this court disclose that they have made demand and they have gone to the company''s office on several occasions demanding their deposit, but the company did not pay even interest.

24. Added to this, this is flagrant violation of the order of this court during the pendency of M. C. A. No. 6 of 1999. After they moved the said application, they themselves sought for an order from this court to suspend their operation and this court believing the company and their affidavit passed an order to suspend their business. Later the company filed C. A. No. 137 of 1999 seeking "to revoke the order of suspension of business and permit the applicant company to recover the loans advanced by the company and retain the amounts for distribution to the company''s creditors as and when this court directs the company after hearing of the company''s petition to sanction the compromise". This court passed the following order ;

"Allowed on condition that the applicant shall during the last week of May file a report with detailed accounts regarding receipts and payments in respect of the company with respect to all transactions of the company. Thereafter, the applicant shall file further statement, every month. Post in the last week of May, 1999."

25. This court passed this order in order to enable the company to collect the amount that the company had advanced to others. So the company is bound based on the order passed by this court to retain all the amounts for distribution as and when the M. C. A. is disposed of or the sanction of the compromise is ordered. A statement filed on September 16, 1999, pursuant to the said order shows that :

"Since the sanction of the compromise scheme got delayed, the company was compelled to give some of these creditors, whose needs could not be postponed any further. These creditors included those whose daughters marriage were fixed, those who needed money for treatment, widows and handicapped persons, senior citizens, persons who entirely depended on this deposits for their livelihood, orphans, etc. Copies of a few of the letters received by the company are attached herewith marked as Ann-(a) series."

26. The company shows worriedness in the delay in passing an order regarding compromise of the scheme. In other words, the company finds fault with the court for the delay in passing an order in M. C. A. Therefore, the company as a

sympathetic measure, in spite of the order passed by the court suspending the operation and in spite of the binding duty to retain the amount to pay off the depositors as and when further order is passed, the company disbursed amounts to persons of its choice. The statement shows that the amount so disbursed is to the tune of Rs. 2,91,56,835 under the head "settlement of creditors". Thus, the company had paid off the creditors of its choice. The reason stated is that several of them were needy, handicapped persons, widows and senior citizens. This payment was made during the period from May 15, 1999 to August 15, 1999. In this regard I have to refer to C. A. Nos. 298 and 299 of 1999 filed in M. C. A. by two of the creditors of the company. They seek payment of 50 per cent. of the accumulated interest. That will be very small and meagre compared to the payments-already made by the company. These C. As. are hotly contested by the company filing counter with the averment that

"The company before sanctioning the scheme of arrangement, cannot pay any amount to its creditors by way of interim payments as prayed for. The company can make the payment only after this Hon''ble Court sanctions this scheme and the payment is done in terms of the resolution already passed at the meeting of the creditors",

27. This counter-affidavit was filed on August 18, 1999, whereas unauthorised payment to the tune of Rs. 2.9 crores as mentioned above had been made during the period from May 15, 1999 to August 15, 1999. This shows that the company had flagrantly violated the order of this court to retain the amount collected, with them. In C. A. No. 137 of 1999 the company sought an order to permit the applicant-company to recover the loans advanced by the company and retain it with them to be disbursed to the creditors as and when order is passed by this court in M. C. A. No. 6 of 1999. In spite of that, they violated that order and disbursed 2.9 crores of rupees to the creditors of their choice, at the same time they contested applications filed before this court seeking interim payment of interest at least, pointing out the excuse that they can effect payment only after sanctioning of the scheme. This is flagrant violation of the order of this court, which has to be proceeded against separately. The company had discriminated among the depositors without paying the applicants in C. A. Nos. 298 and 299 of 1999. Letters addressed by several of the depositors in the company show that they are in need of the money deposited by them in the company for undergoing surgery, for treatment of cancer, for marriage of their daughters, to meet day to day requirements and such other. These persons have, as stated by them approached the company. The company had never paid them at all. The directors of the company, who thus have discriminated against their esteemed and valued depositors, cannot now be allowed to continue the affairs of the company with the proposal that they have made, as there will not be equal consideration towards the entire depositors. When he has dared to violate the order of this court, it cannot be taken that he will abide by the directions of this court. Of course, if he violates, this

court can take him to task; but the violation will for the time being affect the depositors. So such a person cannot be entrusted with the affairs of the company to be continued for disbursement of the deposit amounts in instalments as proposed by him. It is in this regard the contention regarding undue influence exerted by Mr. Boby Varghese has to be viewed. The letter addressed by him to the depositors as annexed to C. A. No. 95 of 1999 contains a caution to the depositors that unless they send the proxy forms duly signed to him, their amount will be lost. In such circumstances he could manage to collect more than 1000 proxy forms only because of such influence or threat contained in such letters addressed to the depositors. The depositors are always interested in their money rather than the whims and fancies of the persons in management. Therefore the vote by Mr. Boby Varghese for and on behalf of 1053 persons who had given proxies can only be considered as due to undue influence.

28. Added to this, there is an important fact reported by the chairman in paragraph 8 of the report. It is reported as follows :

"On a general scrutiny of the votes polled by Sri Boby Varghese, in his capacity as proxy for the depositors, I find that certain votes polled by him in his capacity as proxy have to be treated as invalid votes as those persons who had given proxies themselves had come in person for the meeting and had voted in the meeting. Therefore, the votes polled by Sri Boby Varghese for and on behalf of those persons who had actually participated in the meeting and voted cannot be counted."

29. The details and number of such persons are not given. Thus, there was a chance of dual voting in persons and proxies by some of the persons or there is chance of invalidating the proxy''s votes because those who had given the proxies were present and voted. Therefore, the votes cast by proxy holder, viz., the director of the company Sri Boby Varghese do not reveal the real votes. It is submitted by counsel for the company that even disregarding the entire votes polled by Sri Boby Varghese on proxy the remaining votes in favour of the resolution by the persons present would be sufficient to hold that the resolution was duly passed. Out of 1863 creditors only 893 were present and out of them only 427 voted and all are not in favour of the resolution. 465 persons, more than 50 per cent. per-sons present, did not vote at all. In this background it is submitted that the depositors association had submitted a counter proposal. This is admitted by the chairman in his report. But that counter proposal was not put to vote as according to the chairman''s report when the name of the person who put forward the counter proposal on behalf of the association was called, he was not present. It was 4 p. m. at that time. It is submitted by those who filed objections to the report that there was a walk out by several of the members as Sri Boby Varghese unnecessarily intervened in the meeting and the entire show was stage managed by him and the mike was put off when the objectors had spoken in the meeting. This has to be viewed, in overall circumstances of the conduct of Sri Boby Varghese in the dealings of the company

as also in collecting the proxies as mentioned above. Thus, it is clear that, even as reported by the chairman, the majority of the members present in the meeting did not cast their votes and even several of the votes polled through proxies were not valid, because of the presence of members who had given proxies. Thus the voting conducted cannot reflect the will of the majority of the depositors. The proposal cannot be accepted as there was no proper voting in the meeting of the creditors.

30. As already mentioned there is categoric averment in the affidavit in support of M. C. A. No. 6 of 1999 that :

"The total finance advanced by St. Mary''s Finance Ltd., to St. Mary''s Properties Ltd., is Rs. 7,67,37,784 (rupees seven crores sixty-seven lakhs thirty-seven thousand and seven hundred and eighty-four only)".

31. This is an admission on the part of the company that they had advanced loan to St. Mary''s Properties Ltd. But during the course of the argument, it was submitted that this amount was not given directly to them. It is submitted in the memo filed on July 17, 1999, that one Sri Vinod P. Jacob, a member of the company, had made an application dated March 21, 1994 "for loan of Rs. 5 crores". But the company in M. C. A. No. 6 of 1999 stated that "an application dated March 21, 1994, for loan of Rs. 5 crores was received from a member of the applicant-company, viz., Vinod P. Jacob, which was sanctioned by the company by board resolution dated April 4, 1994". I have examined the minutes book produced by the company upon my direction. The minutes for the meeting dated April 4, 1994, against item No. 3 states as follows :

"The board noted that Mr. Vinod P. Jacob residing at Purakkattil House, Arakkaunnam, has placed an application for a loan of Rs. 5 crores. The board had a thorough discussion on the proposal.

After studying all aspects of the creditworthiness, financial soundness, security aspects and legal implications of the proposal and period of loan and interest rates, it was decided to grant loans up to a limit of Rs. 5 crores to the applicant subject to provisions of adequate security.

The board also authorised the managing director to enter into a memorandum of understanding with the loanee. It was also decided to grant the loan in a spread of 24 years as and when the requirement arises/ availability of funds in sufficient amounts."

32. Thus, this is a loan granted solely to Mr. Vinod P. Jacob. It is stated in the very same memo that :

"Vinod P. Jacob gave a standing instruction dated August 15, 1994, to disburse the future instalments of loan amounts directly to the firm and debit the same to his account. Accordingly as and when the loan amounts were disbursed in instalments, the same were utilised by the firm for its business activities."

33. The firm mentioned as contained in the first sentence in the said statement in the memo, is "St. Mary''s Properties" a partnership firm constituted on August 8, 1994. The instruction from Sri Vinod P. Jacob was to debit the same to his account. Thus as averred by the company in the" said memo Sri Vinod P. Jacob shall continue to be a debtor of the company in respect of the said amount availed of by him as loan. But nothing is mentioned in the affidavit in support of M.C.A. No. 6 of 1999 about his liability or about any amount paid to him. Thus, the averments in the memo filed on July 17, 1999, and the averment in the affidavit of the director of the company in support of M. C. A. do not tally each other, thereby giving rise to the assumption that the company does not disclose sufficient materials with respect to a loan of huge amount granted to one person in his individual capacity. The firm mentioned is not St. Mary''s Properties Ltd., because St. Mary''s Properties Ltd., is a corporate body, from whom amount is said to be due, in the affidavit in support of the application. The company had filed a counter-affidavit in C. A. No. 78 of 1999. That is exhibited as annexure 2 to C. A. No. 218 of 1999 as well. That affidavit is filed by Mr. Boby Varghese himself referring to Schedule 10 to the balance-sheet filed along with M. C. A. No. 6 of 1999, he submits that details of sundry advances include "sum of Rs. 52,88,588 as an advance to a firm St. Mary''s Properties and an advance of Rs. 80,036 to St. Mary''s Properties Ltd.", a corporate body. This is an admission by the company that advances are outstanding against the firm St. Mary''s Properties. As already mentioned above, the company itself had averred in the statement along with the memo filed on July 17, 1999, that the loan had been sanctioned to Mr. Vinod P. Jacob and he had instructed to debit the amount paid to St. Mary''s Properties, a partnership firm, to his account. In such circumstances, how can the amount be one said to be outstanding with St. Mary''s Properties, the said firm, as averred in paragraph 8 of the said counter-affidavit, is not disclosed to this court. This shows that there is utter confusion regarding accounting and amount of loan paid by the company to Mr. Vinod P. Jacob, to St. Mary''s Properties, a partnership firm and also to St. Mary''s Properties Ltd., a corporate body, in each of which as admitted before me, Mr. Boby Varghese is a partner and a director. The statement of accounts furnished as directed by this court on September 28, 1999, shows that an amount of Rs. 7,90,77,618 is outstanding in respect of transactions of Mr. M.C. Jacob as on March 31, 1999. This statement was filed when counsel was asked to submit the details regarding the payments made to St. Mary''s Properties Ltd. It is also admitted before me that the amount made mention of in this statement are the dues from St. Mary''s Properties Ltd., as mentioned in the affidavit in support of the company application.

34. It is further stated in memo dated July 17, 1999, that "Mr. M.C. Jacob ; another member of the applicant-company approached it with a loan application dated September 15, 1995, for a loan of Rs. 5 crores to be disbursed over a period of time. St. Mary''s Properties Ltd., was to furnish security for this loan. This application was placed before the board of directors and the board resolved to sanction the loan in

its meeting dated September 18, 1995." In the minutes book the said matter is as follows :

"The board noted that Mr. M.C. Jacob residing at Mankidiyil House, Mulanthuruthy has placed an application for a loan of Rs. 5 crores. The board had a thorough discussion on the proposal. After studying the security aspects it was decided to grant loan to the applicant upto a limit of Rs. 5 crores, subject to adequate security being furnished."

35. This minutes book does not reflect, as submitted in the said memo as quoted above, that the loan was on behalf of the St. Mary''s Properties Ltd., and the St. Mary''s Properties Ltd., was to furnish securities for the loan advanced to Mr. M.C. Jacob. Really there is no undertaking either from Mr. Vinod P. Jacob or Mr. M.C. Jacob or from St. Mary''s Properties Ltd., to furnish adequate security for the loan, with a memorandum of understanding regarding repayment, executed validly or in accordance with law. I had directed in my order dated July 8, 1999, in M. C. A. No. 6 of 1999 that :

"the company shall also produce the original documents regarding security, guarantee or other steps taken to ensure repayment of loan".

36. A memo has been filed on July 17, 1999, which is already referred to earlier, pursuant to the said order. It is stated in the memo that upon instructions of Mr. M.C. Jacob through letter dated September 28, 1995, loan had been sanctioned and paid in the name of St. Mary''s Properties Ltd., and were debited in the account of Mr. M.C. Jacob. If it is so debited in the account of Mr. M.C. Jacob, necessarily the accounts of the company will not reveal any amount from St. Mary''s Properties Ltd. But as mentioned above the affidavit says that the company had given advance to St. Mary''s Properties.Ltd., to the tune of Rs. 7,67,37,784. It is not explained how the balance-sheet or the accounts show the amount as due from St. Mary''s Properties Ltd., when as stated in memo dated July 17, 1999, Mr. M.C. Jacob to whom the loan had been granted as per minutes extracted, had given instruction to debit the amount paid to St. Mary''s Properties Ltd., in his name. The minutes also show that the securities had to be furnished by Mr. M. C. Jacob. But no security furnished by Mr. M. C. Jacob is produced before me. Pursuant to the said order what is disclosed to this court is that :

"Since St. Mary''s Finance Ltd., felt that the securities already furnished were inadequate for the loans so far availed of both by the firm and St. Mary''s Properties Ltd., through the above said members, it required St. Mary''s Properties Ltd., to furnish further securities. Accordingly St. Mary''s Properties Ltd., offered 250 cents of land in Kakkanad Village in Sy. Nos. 352/2 and 326/1 and 153 cents of land in Kumbalam Village in St. Nos. 58/7, 58/8 and 58/9, in substitution of the existing security."

37. I do not know what the company had meant by this. In the opening portion of the sentence, it is stated that the company felt that the security already furnished was inadequate and, therefore, asked for further security and the further security given as above was according to the company itself, in substitution of the existing security. That means the original security is taken away. Thus, the company''s affairs are in utter confused state. When additional security is furnished necessarily it can be only an addition to the existing security. In the light of the said sentence security now available are only 250 cents of land in Kakkanad and 153 cents of land in Kumbalam for a huge amount of loan of over Rs. 7.67 crores excluding the interest. If it is including interest, as normally charged from the members, it may perhaps exceed Rs. 9 crores. It is clear from the averment in paragraph 5 in the said memo that the company felt that these securities are not sufficient to secure the amount paid. Therefore, further additional security was demanded. It is admitted before me, as averred in the said memo that :

"St. Mary''s Properties had sent a reply expressing their difficulty to repay the loan amount at that time because of the prevalent recession in the real estate market and acceded to furnish additional security to the satisfaction of the company and agreed to create a charge on the properties".

38. The charge as stated above, it is submitted, is in respect of the building where the corporate office of the company is situated, but the charge has been applied to be registered only on March 22, 1999, as admitted by counsel for the company, long after the commencement of the proceedings or filing of the M. C. A. That means there was no proper security even according to the company, in respect of the amount advanced to St. Mary''s Properties Ltd. It is also not disclosed whether any predominant charge is existing over the properties, in favour of any other person or whether there is any court attachment or not in respect of the building. It is submitted by interveners that there are court attachments over these properties and paper reports have also been published with respect to them by a scheduled bank, viz., Federal Bank, in respect of the property in Kakkanad. Normally when a mortgage by deposit of title deed is made between two corporate bodies, it shall be evident from the memorandum signed by the parties. But in this case it is not. It is clear that there is no proper and adequate security for the huge amount advanced either to Mr. Vinod P. Jacob or to Mr. M.C. Jacob or to St. Mary''s Properties, the firm or to St. Mary''s Properties Ltd., a corporate body.

39. It is in these situations as revealed by the records and on the basis of the admitted facts I have to examine the scheme put forward. As already mentioned above, the notice of the meeting itself was illegal as the interests of the directors of the company were not disclosed to the creditors as enjoined u/s 393(1)(a). I have already found that the directors had deep interest in the scheme as the net result of the scheme is postponement of the payment of amount by St. Mary''s Properties Ltd., in which the directors are interested. So that reason itself is sufficient to discard

the scheme. Added to this, there are irregularities in the voting as I have already found. On that reason also the scheme shall be rejected. In spite of these there is a bounden duty attached to this court, while considering a petition u/s 391 to protect the interest of depositors, members, public and of the company. It is contended by the counsel for the company, relying on the decision in Sudarsan Chits (India) Ltd. Vs. Sukumaran Pillai and Others, ; Maneckchowk and Ahmedabad Mfg. Co. Ltd., In re [1970] 40 Comp Cas 819 (Guj) ; Premier Motors (P.) Ltd. Vs. Ashok Tandon and Others, and Registrar of Companies Vs. Navjivan Trading Finance Pvt. Ltd., that the company court shall always favour the working of a scheme rather than winding up of the company. But it is held by the court in Sudarsan Chits (India) Ltd. Vs. Sukumaran Pillai and Others, that (page 107) :

"the court shall examine whether it would be to the advantage of the creditors and even of the company that the court stays its hands on the winding up motion because a motion for settlement has been made in a matter on which the court should certainly deliberate anxiously."

40. It has been held that (page 96) :

"If there is reasonable, if not certain, prospect of its revival and effective and commercially successful functioning, then a short wait by the creditors may be worthwhile."

41. Thus, as held by the court that (page 96) :

"The predominant test would be whether it would be in the best interests of the creditors primarily and the company secondarily to attempt the revival and resuscitation of the company."

42. According to the court these are only broad guidelines, but they can-not be applied to a case as one would apply a precise mathe-matical formula.

43. As held by the court (page 108) :

"the approach of the court while examining the scheme must be on the basis of the principle pointed out in the decision in In Re: Sidhpur Mills Co. Ltd., , and keeping in view all the aspects of the matter, the court must prefer a living scheme to compulsory liquidation bringing about an end to a company."

44. Such a scheme should envisage functioning of the company in a normal way. As already mentioned above, the object of the present company is to encourage the habit of thrift to lend or advance money to the creditors, and members and to receive deposits from members. The company is aware of the present situation in which it is placed. This is not a secret, but known to the public as well. So the company cannot accept any more deposits from its members in the present situation at least immediately as none will dare to do so. At the same time, the company has to pay off all its debts to the depositors. A large amount due from St.

Mary''s Properties Ltd., as mentioned above cannot be got repaid in the immediate future. As admitted by the company there is recession nowadays and there is stagnation in the real estate market, in which St. Mary''s Properties Ltd., is engaged. This is an admitted position before me and it is averred in the affidavit of the company itself. In paragraph 7 of the memo dated July 17, 1999, the company has stated that :

"St. Mary''s Properties Ltd., had sent a reply expressing their difficulty to repay the loan amount at that time because of the prevalent recession in the real estate market."

45. The company has no case before me that recession is over. It is submitted in M. C. A. No. 6 of 1999 itself that there was an unexpected crash in the share market and by reason of that the St. Mary''s Properties could not come into public and had to abandon the scheme for public issue of its shares. It was further averred in paragraph 11 of the affidavit that "the overall recession prevalent today has created a situation by which the company has to face liquidity crisis". Therefore, if the scheme is allowed to be worked out, the company itself cannot work in terms of its objects as anybody will not be depositing any amount in the company and the company is unable to pay its depositors, in terms of the contract with the depositors and company. If it was a manufacturing concern the production would have been envisaged. The only function of the company is receiving and lending money. When that comes to a standstill as they cannot borrow because of the present situation and as they cannot repay the deposit in accordance with the commitment, the company will not be functioning as envisaged in the memorandum of association. The substratum of the company thus comes to an end. Then no purpose will be served in continuing the company except to promote the interest of its directors, namely, delay the collection of the money lent to St. Mary''s Properties Ltd. In such circumstances, even going by the decision reported in Sudarsan Chits (India) Ltd. Vs. Sukumaran Pillai and Others, as the scheme is not a living scheme, there is no reason for accepting the same, even if the notice and voting were proper. When the substratum of the company is gone, there will be no point in the existence of the company. As held by the Calcutta High Court in Bombay Gas Co. Ltd. v. Hindustan Mercantile Bank Ltd. [1980] 50 Comp Cas 202 it is just and equitable to wind up the company having regard to the fact that the substratum of the company is gone. When the object of the company and business of the company are tested with the objects made mention of in the memorandum of association, if the scheme is allowed to work, the functioning of the company will come to a standstill resulting in the ending of its substratum itself. When the business of the company is thus gone, as held by the said court, it must be held that the substratum of the company is also gone. Therefore, in law also there is no reason to accept the scheme. This being the legal position, the other cases cited by counsel for the company do not advance anything in favour of the scheme now presented.

46. At the same time the winding up of the company, will result in grave concern to its depositors and great panic will be created among them. There are admittedly loans and advances, considered good to the tune of Rs. 10 crores. Interest is also due on the said amount. If that could be realised, necessarily majority of the creditors could be satisfied. The nominal securities available from the St. Mary''s Properties Ltd., also can be made use of for that purpose. To enable that and to, materialise such realisation in the near future, the company should be in the control of somebody else than the present directors. Section 450 of the Act enables this court to appoint the official liquidator as provisional liquidator, without formally passing a winding up order or even keeping the winding up in pending, in exercise of the discretion vested in the court. At the same time the provisional liquidator will have the powers of the liquidator, with the permission of this court under the provisions contained in Section 450(3). This will enable him to take steps for speedy recovery of the dues to the company. It is also possible in terms of the provisions contained in Section 457(1)(b), to allow the provisional liquidator to carry out the business of the company to the extent as mentioned above, viz., at least with respect to the collection of the amount due to the company and to pay off its creditors. In that regard if necessary with the permission of this court, as provided for in Clause (v) of Section 457, he can employ a competent agent to look after its affairs. It is, therefore, necessary to think if such a situation so that the interest of the larger number of the depositors who alone need care of this court as far as the company is concerned shall be protected.

47. Before passing an order in this regard, it is necessary to consider the contention raised with respect to C. P. No. 18 of 1999, wherein the winding up of the company is sought for. As already mentioned, copy had been served on the company and the company has filed a counter-affidavit also. Counter-affidavit also almost revealed the aforesaid facts. Therefore, both the M. C. A. and C. P. are taken together. There are several allegations in the C. P. It is submitted that no reason is stated for exceeding the limit of lending to a particular person in excess of Rs. 7.5 lakhs or lending to a corporate body in violation of the regulations and notifications issued by the Central Government. Even if there will be such grave irregularities on the part of the company, in order to protect the interest of the depositors, it will not be proper to order winding up at present. Accordingly, I am of the view that there shall be a scheme for the working of the company as formulated below :

(1) The business of the company to the extent of collecting the loan advanced by it and paying off the depositors shall continue ;

(2) For that purpose the official liquidator is appointed as the provisional liquidator in terms of Section 450 ;

(3) He shall carry on the business of the company except the acceptance of deposits ;

(4) He shall take earnest and speedy endeavour to collect the loans advanced by the company including to St. Mary''s Properties Ltd., to the firm St. Mary''s Properties, to Mr. Vinod P. Jacob and to Mr. M. C. Jacob and also to other debtors who had taken advance from the company ;

(5) The provisional liquidator shall also release the gold pledged to the company on receipt of the amount with interest in terms of the agreement for such transaction ;

(6) For the purpose of transacting such business the official liquidator can appoint an agent as provided for in Section 457(2)(v) of the Act, with the permission of this court and he shall function upon directions from the official liquidator and also from this court ;

(7) The agent shall furnish every fortnight a statement of accounts regarding the amount received, securities released, etc. ;

(8) The payment towards creditors will be decided in terms of the amount so collected ;

(9) It is free for the applicants in several of the C. As. or any other depositors to approach this court for appropriate relief including interim payments to be effected by the provisional liquidator ;

(10) The official liquidator shall also form a committee to assist himself and the agent, from among the depositors of the company ;

(11) For the time being, the president of the existing depositors'' association shall be the nominee and the official liquidator can, after convening a meeting of all the creditors, elect three representatives from them to be members of the committee, within three months from today ;

(12) Mr. Boby Varghese, the director, who has filed affidavit in support of the M. C. A. shall also be a member of the said committee. So that his assistance can also be taken by the provisional liquidator and agent to collect the amount, to identify the securities and to spot out the debtors;

(13) The official liquidator shall within four months from today identify the bad debts or debts without sufficient securities and the payments made to Mr. Vinod P. Jacob, Mr. M.C. Jacob, St. Mary''s Properties Ltd., a corporate body and St. Mary''s Properties, the firm and shall take action to realise those amounts from them and shall report to this court, periodically. No debt shall become time barred from today or any day after today ;

(14) The official liquidator shall also within six months from today file a report with regard to misfeasance, if any, that had taken place in the affairs of the company ;

(15) The-official liquidator is also enabled, for the working of the scheme to seek any further clarifications ;

(16) The provisional liquidator shall forthwith, take over the entire assets of the company and its records ;

(17) The applicant in M. C. A. shall render necessary help to the official liquidator in that regard ; and

(18) The official liquidator can function the office of the company in the same premises as it is now functioning.

48. No further orders are required in the M. C. A.

49. The C. P. will be taken up as and when necessary depending upon the working of the aforesaid scheme.