R. Sivakumar Vs SRP Tools Limited and Subramanian Engineering Limited

Court: Madras High Court

Date of Decision: Nov. 17, 2009

Acts Referred: Companies Act, 1956 â€" Section 235, 236, 237, 238, 239
Income Tax Act, 1961 â€" Section 19(AA), 2(19AA), 72A(5)

Hon'ble Judges: Prabha Sridevan, J; M. Sathyanarayanan, J

Bench: Division Bench

Advocate: K. Balakrishnan, for the Appellant; A.K. Mylsamy in OSA. 143 /2005 and R. Murari, for A.L. Gandhimathi in OSA. 144/2005, for the Respondent

Final Decision: Dismissed

Judgement

Prabha Sridevan, J.
The appellant is a minority shareholder and the objector to the Scheme of Arrangement between the respondents,

SRP Tools Limited (Transferor Company) (TC1 in short) and Subramanian Engineering Limited(Transferee Company) (TC2 in short). TC1

originally had two undertakings one at Ranipet and the other at Chennai. TC1 decided to demerge the Chennai Undertaking with TC2. TC1 and

TC2 filed C.P. Nos. 38 and 39 of 2005 respectively under Sections 391 and 394 of the Companies Act, seeking sanction of the scheme of

arrangement. The details of the scheme of arrangement was arrived at in the Extraordinary General Meeting held on 05-02-2005. The Chennai

Undertaking of TC1 which had to be demerged from TC1 was defined in the scheme of arrangement. The details of the assets were also set out.

The net assets had to be transferred at the book value as a going concern and after demerger the rest of the business and assets of TC1 would

continue to vest with it. As a consideration for a transfer and vesting of the demerged company with TC2, the Scheme provided for allotment of

one equity share of Rs. 10/- value in TC2 to the shareholders of TC1 for every five shares held by them in TC1. This scheme also provided that

the shareholding pattern of the TC2 will be in the same proportion as the TC1 in respect of all the shareholders including the promoters. The main

reason for demerger was that the demerged company intended to manufacture automobile components as it had sufficient space at Chennai. The

Scheme of Arrangement was passed by the overwhelming majority of the shareholders. The newspaper publication was effected on 17-02-2005.

In March 2005, the Regional Director, Central Government filed the report stating that both the companies have their registered office at Chennai

and the shareholders of TC1 had approved the scheme by overwhelming majority. The Regional Director also enclosed the objections raised by

the appellant herein. This shareholder holding 3200 shares attended the meeting and voted against the scheme and yet, the scheme was approved

by a overwhelming majority. The learned Single Judge on a consideration of the materials ordered both the petitions has prayed for.

2. The learned Counsel appearing for the appellant submitted that for demerger, valuation report is a vital document and there are three methods of

valuation a) yield, (b) Market price, (c) Net Asset Value of the Company. This should be done by an expert Auditor. Whereas in the present case,

the Auditor had not valued both the companies but only TC1 and the details of land is not known. The Auditor"s report itself is carefully worded

and it shows that ""the report is based on the information received from the sources mentioned in this report. The information has not independently

been verified by us."" It is on the basis of this cursory and inadequate report that the order had been passed. According to the learned Counsel, the

latest financial position of TC1 should have been filed along with the company petition and the book value cannot be taken. The learned Counsel

submitted that the scheme was against the interest of the minority shareholders and TC2 itself was constituted only with the intention to take away

the valuable assets of TC1. The learned Counsel submitted that the Auditor should be independent of the Board of Directors of the Company and

he should play a role of watch-dog on behalf of the shareholders of the company vide 83 Comp. Cas 30 (Hindustan Lever Employees" Union v.

Hindustan Lever Ltd. and Ors.). The Auditor in this case does not appear to have done this role.

3. The learned Counsel appearing for the respondents would submit that the word ""demerger"" is not defined in the Companies Act. But only in

Section 2(19AA) of the Income Tax Act and the Explanation to this Section clearly says that the valuation appearing in the books of account

immediately before the date of demerger should be taken into account. The learned Counsel submitted that otherwise they will not get the benefit

under the Income Tax Act. There was no concealment of the real value of the property. The valuation report has taken into account all the relevant

factors. The learned Counsel also submitted that the overwhelming majority of the shareholders had approved of the scheme of arrangement. The

Scheme cannot be rejected on account of one object.

4. Section 2(19(AA)) of the Income Tax Act reads thus:

Section 19(AA) ""demerger"", in relation to companies, means the transfer; pursuant to a scheme of arrangement under Sections 391 to 394 of the

Companies Act, 1956 (1 of 1956), by a demerged company of its one or more undertakings to any resulting company in such a manner that--

(i) all the property of the undertaking, being transferred by the demerged company, immediately before the demerger, becomes the property of the

resulting company by virtue of the demerger;

(ii) all the liabilities relatable to the undertaking, being transferred by the demerged company, immediately before the demerger, become the

liabilities of the resulting company by virtue of the demerger;

(iii) the property and the liabilities of the undertaking or undertakings being transferred by the demerged company are transferred at values

appearing in its books of account immediately before the demerger;

(iv) the resulting company issues, in consideration of the demerger, its shares to the shareholders of the demerged company on a proportionate

basis;

(v) the shareholders holding not less than three-fourths in value of the shares in the demerged company (other than shares already held therein

immediately before the demerger, or by a nominee for, the resulting company or, its subsidiary) become shareholders of the resulting company or

companies by virtue of the demerger, otherwise than as a result of the acquisition of the property or assets of the demerged company or any

undertaking thereof by the resulting company;

(vii) the transfer of the undertaking is on a going concern basis;

(viii) the demerger is in accordance with the conditions, if any, notified under Sub-section (5) of Section 72A by the Central Government in this

behalf.

Explanation I.- For the purposes of this clause, ""undertaking"" shall include any part of an undertaking, or a unit or division of an undertaking or a

business activity taken as a whole, but does not include individual assets or liabilities or any combination thereof not constituting a business activity.

Explanation 2.- For the purposes of this clause, the liabilities referred to in sub-clause(ii),shall include--

(a) the liabilities which arise out of the activities or operations of the undertaking;

(b) the specific loans or borrowings (including debentures) raised, incurred and utilised solely for the activities or operations of the undertaking; and

(c) in cases, other than those referred to in Clause (a) or Clause (b), so much of the amounts of general or multipurpose borrowings, if any, of the

demerged company as stand in the same proportion which the value of the assets transferred in a demerger bears to the total value of the assets of

such demerged company immediately before the demerger.

Explanation 3. -- For determining the value of the property referred to in Sub-clause (iii), any change in the value of assets consequent to their

revaluation shall be ignored.

Explanation 4.-- For the purposes of this clause, the splitting up or the reconstruction of any authority or a body constituted or established under a

Central, State or Provincial Act, or a local authority or a public sector company, into separate authorities or bodies or local authorities or

companies, as the case may be, shall be deemed to be a demerger if such split up or reconstruction fulfils[such conditions as may be notified in the

Official Gazette, by the Central Government];

5. In 83 Comp Cas 30 (supra), the Supreme Court observed that the ""valuation of shares is a technical matter. It requires considerable skill and

experience...the test of fairness of this valuation is not whether the offer is fair to a particular shareholder."", that ""notice must be taken of the fact

that even after these points were raised in the meeting, the overwhelming majority of the shareholders vote for the scheme,"" and that the fact that

the explanatory statement was approved by the Registrar itself is a relevant factor and therefore, the Supreme Court accepted the determination of

value.

6. In Miheer H. Mafatlal Vs. Mafatlal Industries Ltd., the Supreme Court held thus:

28. The relevant provisions of the Companies Act, 1956 are found in Chapter V of Part VI dealing with ''Arbitration, Compromises,

Arrangements and Reconstructions''. In the present proceedings we will be concerned with Sections 391 and 393 of the Act. The relevant

provisions thereof read as under:

391. (1) Where a compromise or arrangement is proposed

(a) between a company and its creditors or any class of them; or

(b) between a company and its members or any class of them; the Court may, on the application of the company or of any creditor or member of

the company, or in the case of a company which is being wound up, of the liquidator, order a meeting of the creditors or class of creditors, or of

the members or class of members, as the case may be, to be called, held and conducted in such manner as the Court directs.

(2) If a majority in number representing three-fourths in value of the creditors, or class of creditors, or members, or class of members as the case

may be, present and voting either in person or, where proxies are allowed under the rules made u/s 643, by proxy, at the meeting, agree to any

compromise or arrangement, the compromise or arrangement shall, if sanctioned by the Court, be binding on all the creditors, all the creditors of

the class, all the members, or all the members of the class, as the case may be, and also on the company, or, in the case of a company which is

being wound up, on the liquidator and contributories of the company:

Provided that no order sanctioning any compromise or arrangement shall be made by the Court unless the Court is satisfied that the company or

any other person by whom an application has been made under Sub-section (1) has disclosed to the Court, by affidavit or otherwise, all material

facts relating to the company, such as the latest financial position of the company, the latest auditor''s report on the accounts of the company, the

pendency of any investigation proceedings in relation to the company under Sections 235 to 251, and the like.

393. (1) Where a meeting of creditors or any class of creditors, or of members or any class of members, is called u/s 391,

(a) with every notice calling the meeting which is sent to a creditor or member, there shall be sent also a statement setting forth the terms of the

compromise or arrangement and explaining its effect, and in particular, stating any material interests of the directors, managing directors, managing

agents, secretaries and treasurers or manager of the company, whether in their capacity as such or as members or creditors of the company or

otherwise, and the effect on those interests, of the compromise or arrangement, if, and insofar as, it is different from the effect on the like interests

of other persons; and

(b) in every notice calling the meeting which is given by advertisement, there shall be included either such a statement as aforesaid or a notification

of the place at which and the manner in which creditors or members entitled to attend the meeting may obtain copies of such a statement as

aforesaid.

The aforesaid provisions of the Act show that compromise or arrangement can be proposed between a company and its creditors or any class of

them or between a company and its members or any class of them. Such a compromise would also take in its sweep any scheme of

amalgamation/merger of one company with another. When such a scheme is put forward by a company for the sanction of the Court in the first

instance the Court has to direct holding of meetings of creditors or class of creditors or members or class of members who are concerned with

such a scheme and once the majority in number representing three-fourths in value of creditors or class of creditors or members or class of

members, as the case may be, present or voting either in person or by proxy at such a meeting accord their approval to any compromise or

arrangement thus put to vote, and once such compromise is sanctioned by the Court, it would be binding to all creditors or class of creditors or

members or class of members, as the case may be, which would also necessarily mean that even to dissenting creditors or class of creditors or

dissenting members or class of members such sanctioned scheme would remain binding. Before sanctioning such a scheme even though approved

by a majority of the concerned creditors or members the Court has to be satisfied that the company or any other person moving such an

application for sanction under Sub-section (2) of Section 391 has disclosed all the relevant matters mentioned in the proviso to Sub-section (2) of

that section. So far as the meetings of the creditors or members, or their respective classes for whom the Scheme is proposed are concerned, it is

enjoined by Section 391(1)(a) that the requisite information as contemplated by the said provision is also required to be placed for consideration of

the voters concerned so that the parties concerned before whom the scheme is placed for voting can take an informed and objective decision

whether to vote for the scheme or against it. On a conjoint reading of the relevant provisions of Sections 391 and 393 it becomes at once clear that

the Company Court which is called upon to sanction such a scheme has not merely to go by the ipse dixit of the majority of the shareholders or

creditors or their respective classes who might have voted in favour of the scheme by requisite majority but the Court has to consider the pros and

cons of the scheme with a view to finding out whether the scheme is fair, just and reasonable and is not contrary to any provisions of law and it

does not violate any public policy. This is implicit in the very concept of compromise or arrangement which is required to receive the imprimatur of

a court of law. No court of law would ever countenance any scheme of compromise or arrangement arrived at between the parties and which

might be supported by the requisite majority if the Court finds that it is an unconscionable or an illegal scheme or is otherwise unfair or unjust to the

class of shareholders or creditors for whom it is meant. Consequently it cannot be said that a Company Court before whom an application is

moved for sanctioning such a scheme which might have got the requisite majority support of the creditors or members or any class of them for

whom the scheme is mooted by the company concerned, has to act merely as a rubber stamp and must almost automatically put its seal of

approval on such a scheme. It is trite to say that once the scheme gets sanctioned by the Court it would bind even the dissenting minority

shareholders or creditors. Therefore, the fairness of the scheme qua them also has to be kept in view by the Company Court while putting its seal

of approval on the scheme concerned placed for its sanction. It is, of course, true that so far as the Company Court is concerned as per the

statutory provisions of Sections 391 and 393 of the Act the question of voidability of the scheme will have to be judged subject to the rider that a

scheme sanctioned by majority will remain binding to a dissenting minority of creditors or members, as the case may be, even though they have not

consented to such a scheme and to that extent absence of their consent will have no effect on the scheme. It can be postulated that even in case of

such a scheme of compromise and arrangement put up for sanction of a Company Court it will have to be seen whether the proposed scheme is

lawful and just and fair to the whole class of creditors or members including the dissenting minority to whom it is offered for approval and which

has been approved by such class of persons with requisite majority vote.

Consequently the Company Court''s jurisdiction to that extent is peripheral and supervisory and not appellate. The Court acts like an umpire in a

game of cricket who has to see that both the teams play their game according to the rules and do not overstep the limits. But subject to that how

best the game is to be played is left to the players and not to the umpire.

7. In 124 CompCas 531(Parke-Davis (India) Ltd., Inre), the learned Single Judge of the Bombay High Court while dealing with the objections

raised by certain shareholders held that the Court has to see how the members were the best judges of their own interest had voted on the

Resolution and the overwhelming majority of the shareholders have voted in favour, which would not be interfered with.

8. In 121 Compcas 523(Larsen and Toubro Limited, In re), the learned Single Judge of the Bombay High Court dealt with demerger. The learned

Counsel referred to 1960 30 Comp Cas 536 Sussex Brick Co. Ltd., In re wherein it is held that, ""It must be affirmatively established that,

notwithstanding the view of the majority, the scheme is unfair, and that is a different thing from saying that it must be established that the scheme is

not a very fair or not a fair one; the scheme has to be shown affirmatively, patently, obviously and convincingly to be unfair"".

9. We are unable to accept the objections of the appellant. The provisions of the Income Tax Act provides that it is only book value that has to be

taken. The scheme had been approved by a overwhelming majority and the shareholders of the demerged company would hold shares in the same

proportion in which the shares would be held by them in the demerged company. Though the word ""demerger"" is not specifically defined in

Sections 391 to 394 of the Companies Act which deals with all the ingredients of demerger. In fact, in the order that is challenged herein, we find

that taking into account the objections forwarded by the Registrar, the Court had heard the objector and the learned Judge found that the

transferors Company/shareholders were not frequently traded and the transferee company shares are not at all listed and the valuation of shares

were accepted by the majority of the shareholders and therefore, the learned Single Judge rightly did not interfere with the exchange share ratio as

being palpably exchanged or illegal. It would appear that bonus shares three times at the ratio of 1:1 had been allotted by the transferor company.

10. One of the grounds raised by the learned Counsel for the appellant was that the Supreme Court in Hindustan Levers case had set that the

valuation must be tested by two independent bodies. We do not think that was laid down as a legal dictum. In that case, the value was determined

by one expert. Then an application was taken out for a direction to a firm of Chartered Accountants to give their opinion on the valuation report.

The firm gave its conclusion that the exchange ratio fixed originally was correct. Thereafter, another valuation report made by another valuer was

produced which was slightly different. The Supreme Court merely held that the original valuer had adopted the three well-known methods of the

valuation of the shareholders and the overwhelming majority had approved of the valuation and therefore, Court should not interfere with such

values and therefore, it was on an application for a direction to appoint an independent valuer that a valuation is made. Therefore, learned Single

Judge had rightly observed, ""and I also went through the judgment and no such legal requirement is pronounced in that judgment."" Therefore, the

pratice of valuing the shares at quoted market value did not arise.

11. For all these reasons, we see no reason to interfere with the order of the learned Single Judge. The appeal is therefore, dismissed.