(2009) 11 MAD CK 0171

Madras High Court

Case No: O.S.A. No"s. 143, 144 of 2005 and C.M.P. No. 11680 of 2005

R. Sivakumar	APPELLANT
Vs	
SRP Tools Limited and Subramanian Engineering Limited	RESPONDENT

Date of Decision: Nov. 17, 2009

Acts Referred:

- Companies Act, 1956 - Section 235, 236, 237, 238, 239
- Income Tax Act, 1961 - 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.